STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105

FINAL STATEMENT OF REASONS

May 12, 2008 **REG-2006-00009**

DISABILITY INCOME INSURANCE BENEFIT REDUCTION REGULATIONS

UPDATED INFORMATIVE DIGEST

The Department's Informative Digest remains accurate and is incorporated by reference herein, subject to the following updates:

On April 8, 2008 the Department issued a Notice of Availability of Revised Text for the proposed regulations. The Department determined that the following changes were advisable, for the following reasons:

1. Section 2232.45.1. Authority and Purpose.

a. The original language of this section did not include a description of the substance of section 2232.45.5 in its description of the purpose of Article 2.2. Section 2232.45.5 concerns the insurer's duty of good faith and fair dealing in estimating earnings received by the insured for work performed while disabled, and it is a part of Article 2.2. The Department added language to section 2232.45.1 to correct this inconsistency, by including a description of the substance of section 2232.45.5 in section 2232.45.1's description of the purpose of Article 2.2.

b. The original language of this section stated that the article applies to all forms which provide for group disability income insurance coverage and which are subject to approval under the California Insurance Code ("CIC"). However, this statement is inconsistent with section 2232.45.5, which applies to all insurers authorized to transact disability insurance in this State. Therefore, in order to resolve this inconsistency, the Department amended section 2232.45.1 so that the article applies to all insurers authorized to transact disability insurance in California. It then amended sections 2232.45.2, 2232.45.3, and 2232.45.4 so that their scope was not enlarged. Sections 2232.45.2, 2232.45.3, and 2232.45.4 apply to policies of group disability income insurance which are subject to approval under the California Insurance Code.

2. Section 2232.45.2. Benefit Reductions Shall Not Be Based on Involuntary Retirement.

a. As stated above, the Department amended this section so that it states that it applies only to policies of group disability income insurance which are subject to approval under the

California Insurance Code. The Department re-worded the section by changing “could” to “would,”, deleting a comma, and re-phrasing language concerning the insured’s voluntary retirement without changing the substance of the regulation, in order to make the regulation clearer. The Department changed the “PERS” reference to the more inclusive and accurate “Public” because the scope of the regulation is not limited to PERS, which is just one type of public normal retirement age benefit.

b. The Department received public comments indicating that there was a potential clarity problem with section 2232.45.2 in that it was unclear to some whether the section applied in instances in which an insured was receiving benefits because he or she had voluntarily retired. The Department amended the regulation to clarify that the regulation did not apply in those instances. The regulation now states that it does not prohibit an insurer from deducting the amount of a benefit listed, to the extent the benefit is deductible under existing law, when the benefit has been received by the insured as a result of the insured’s voluntary retirement.

c. The Department received public comments stating that the Department did not have legal authority or support for the regulation. The Department amended section 2232.45.2 to include citations to *Gruenberg v. Aetna Insurance Company* (1973) 9 Cal.3d 566, and *Smith v. Alum Rock Union Elementary School District* (1992) 6 Cal. App.4th 1651 as additional support and refinement for the authority and reference citations already cited. The *Gruenberg* case is cited for holding that an insurer owes to its insured an implied-in-law duty of good faith and fair dealing that it will do nothing to deprive the insured of the benefits of the policy. *Gruenberg,* 9 Cal.3d 566 at 575. The Department had already cited G*ruenberg* as a reference citation for section 2232.45.5. The Department added the citation to *Gruenberg* as an additional reference citation for section 2232.45.2, to note that an insurer’s obligation to comply with the *Kalvinskas* case would be part of the insurer’s duty of good faith and fair dealing.

The *Smith* case held that the exclusion of employees from eligibility for disability benefits based solely on age, pursuant to Cal. Education Code section 23902, so that those employees were forced to choose the less desirable option of retirement, was an “involuntary retirement” prohibited by the ADEA (29 U.S.C. section 623(f)(2)). In the *Smith* case the employee was a teacher, and her benefits were from a public source (State Teachers’ Retirement System) rather than a private source. The Department cites *Smith* in response to public comments that the holding of the *Kalvinskas* case on violations of the ADEA does not apply when public benefits are at issue. Section 2232.45.2 includes public retirement benefits, and the citation to the *Smith* case simply provides more specific reference authority for the language of the regulation.

3. Section 2232.45.3. Benefit Reductions Shall Not Be Based on Estimated Workers’ Compensation Temporary Disability Benefit Not Actually Received by the Insured.

a. As stated above, the Department amended this section so that it states that it applies only to policies of group disability income insurance which are subject to approval under the California Insurance Code. The Department amended this section to correct the spelling and punctuation of “worker’s compensation” to “workers’ compensation.” The ‘Department changed the word “could” to “would” in an effort to increase clarity.

4. Section 2232.45.4. Benefit Reductions Shall Not Be Based on Workers’ Compensation Permanent Disability.

a. As stated above, the Department amended this section so that it states that it applies only to policies of group disability income insurance which are subject to approval under the California Insurance Code. The Department amended this section to correct the spelling and punctuation of “worker’s compensation” to “workers’ compensation.” The Department received public comments that permanent workers’ compensation benefits “cover the same risk” as disability income insurance policies, and should therefore be offset against benefits under the policies, and comments that the Department was misinterpreting the *Russell* case. In response, the Department added the citation to *Canova v. NLRB* (9th Cir. 1983) 708 F.2d 1498. The *Canova* decision does not hold that permanent workers’ compensation benefits “cover the same risk” as long term disability policies. The court in *Canova v. N.L.R.B.* (9th Cir. 1983) 708 F.2d 1498 held that an award “which is reparation for permanent physical injury…is not compensation for lost wages during a particular period and is not deductible” from a backpay award. *Canova v. N.L.R.B.,* 708 F.2d 1498 at 1504. The *Canova* court cited and quoted the *Russell* case in support of its holding. The court in the *Canova* case cites the *Russell* decision for the same point of law as does the Department. The *Canova* case provides support for the Department’s citation and interpretation of *Russell.*

5. Section 2232.45.5. Benefit Reductions Based on Earnings Received for Work Performed While Disabled.

a. The only change to this section was a grammatical change, changing “it’s” to “the” to improve clarity.

6. Section 2536.2 Advertisements of Benefits Payable, Losses Covered or Premiums Payable.

a. The Department received comments that the regulation was too broad and burdensome, because it (1) applied to all advertisements, and (2) required a description of each reduction and the circumstances under which the reduction would apply. These comments are well-founded. In response, the Department amended the regulation to narrow its scope and narrow its requirements. The amended regulation no longer applies to all advertising, but instead applies only to detailed forms of advertising known as “invitations to contract.” The regulation’s disclosure requirements have been narrowed as well, so that the invitation to contract need not contain descriptions of “each such reduction and the circumstances under which the reduction would apply.” Instead, the invitation to contract need only contain an example of how “at least two common reductions” would reduce the dollar amount of the maximum benefit that an insured would receive.

b. The Department received public comments that the required dollar amount example could mislead some people into thinking that the example reflected their particular situation. The

Department responded by amending the regulation to include a sentence stating that the insurer may couple the example of benefit reductions with a disclaimer which explains that the example is illustrative only and is not intended to reflect the situation of a particular claimant under the policy.

c. For improved clarity, the Department amended the regulation by inserting the words "dollar" and "maximum" to specify that the example shows the "dollar" amount of the "maximum" benefit. The Department made other minor changes for clarity and to conform the regulation to the public comments mentioned above, such as substituting "an" for "the," "example" for "information," deleting "stating" and replacing it with "showing in a dollar amount example," and deleting "what may reduce the benefit amount, and." For accuracy, the regulation was amended to state that it is designed to "better explain" rather than "fully disclose" the effect of benefit reductions.

On April 24, 2008 the Department issued a Notice of Availability of Revised Text for the proposed regulations. The Department determined that the following changes to the regulations were advisable, for the following reasons:

a. The Department received additional public comments with regard to the April 8, 2008 version of the regulations which questioned the Commissioner's rulemaking authority for the regulations. In response to these comments, the Department added citations to *CalFarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, and *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216 to all regulation sections as additional authority supporting the Commissioner's rulemaking authority to implement, interpret, and make specific provisions of the Insurance Code. These citations do not expand the scope of the regulations, but rather confirm that the Commissioner has implied rulemaking authority in addition to the express rulemaking authority already cited as CIC section 790.10. At the suggestion of a commentator, the Department also added a citation to CIC section 790.02 to all regulation sections as a reference statute. Section 790.02 prohibits the acts and practices listed in section 790.03, which is also cited as reference for each section. However, even without the addition of the citation to section 790.02, the acts and practices set forth in section 790.03 are still forbidden.

b. The Notice of Availability of Revised Text that was made available to the public with the April 8, 2008 version of the regulations stated that all additions to the regulations were double-underlined. Due to clerical error, some additions were only single-underlined in the regulation text. To ensure that the public has an opportunity to comment on the portions of the text that were single-underlined in error, these portions of the text were included in the portions of the text that were marked with dotted underline, to indicate additional changes, and were re-noticed for comment on April 24, 2008. The language which was re-noticed for public comment in this manner is the changes to section 2232.45.2 described above, excluding the dotted underlined language that cites to the *CalFarm* and *20th Century* cases and CIC section 790.02.

c. The Department received public comments stating that most long-term disability income insurance policies cover the same risk as workers' compensation permanent disability benefits. The Department believes this position is incorrect. In response to the comments, the Department added a citation to the *Erreca* case to reference its definition of disability coverage. Under

Erreca v. Western States Life Ins. Co. (1942) 19 Cal.2d 388, disability coverage "is designed to provide a substitute for earnings when, because of bodily injury or disease, the insured is deprived of the capacity to earn his living. (citation omitted) It does not insure against loss of income." *Erreca v. Western States Life Ins. Co.* (1942) 19 Cal.2d 388, at 397. This is not the same thing as workers' compensation permanent disability benefits, which the court in *Canova v. N.L.R.B.* (1983) 708 F.2d 1498 held are "reparation for permanent physical injury…is not compensation for lost wages during a particular period and is not deductible" from a backpay award. *Canova v. N.L.R.B.* (1983) 708 F.2d 1498, 1504. The citation to *Erreca* helps to clarify the nature of the disability coverage to which the regulation applies and the difference between that type of coverage and workers' compensation permanent disability benefits. The Department cited the *Erreca* case for its definition of disability income insurance policies in the Notice of Proposed Action and Notice of Public Hearing, Informative Digest, Policy Statement Overview.

d. In response to a suggestion in public comments, the Department amended section 2232.45.5 to refer to "certificate holder" rather than "insured." While "insured" is not inaccurate, the insured individual is also referred to as the "certificate holder" in the context of group coverage.

On April 24, 2008 the Department also issued a Notice of Addition to Rulemaking File for the proposed regulations. The Department added the documents listed below for the reasons set forth below.

<u>Category One: Insurance company advertisements and related materials</u>. These documents were added to the rulemaking record to show the kinds of advertisements and marketing materials, including enrollment materials, which insurers provide to the public concerning group disability income insurance. The materials show various kinds of benefit reductions and how they are disclosed to the public. The materials also include excerpts from policy forms which show benefit reduction provisions.

1.The Hartford's Broker/Employer Brochure, titled "Disability Literacy Study: Unintended Exposure: The Surprising 'Big Gamble' Employees Take Every Day," provided to brokers or employers/policyholders presale and postsale
2.The Hartford's Employee Brochure: "Income Protection for Long-Term Disabilities," provided to employees/certificate holders pre- and post-enrollment
3.The Hartford's Employee Brochure: "Income Protection for Short-Term Disabilities," provided to employees/certificate holders pre- and post-enrollment
4.The Hartford's Benefit Highlight Sheets: "Disability Benefit Highlights," "Long-Term Disability Benefit Highlights," and "Short-Term Disability Benefit Highlights," provided to employees/certificate holders pre-enrollment (sample policyholder name redacted)
5.The Prudential Insurance Company of America's flyer (policyholder's name redacted), form number IFS-A123674 Ed. 0906 "Disability Insurance Can Help Your Employees When They Need Help Most," provided to employees of group policyholder
6.The Prudential Insurance Company of America's Custom Enrollment Material for Group "Long Term Disability Insurance" (policyholder's name and rate information redacted), forms IFS-A091258 Ed. 3/2005 ECEd.5.2006-1904 EXP.11.2007 and GL 2005.055 Ed. 3/2005 ECEd.5.2006-0973 EXP.11.2007

7.The Prudential Insurance Company of America's Custom Enrollment Material for Group Non-Exempt Employees "Long Term Disability Insurance" (policyholder's name and rate information redacted), forms IFS-A091258 Ed.3/2005 ECEd.5.2006-1905 EXP.11.2007 and GL.2005.055 Ed.3/2005 ECEd.5.2006-0974 EXP.11.2007
8.The Prudential Insurance Company of America's Custom Enrollment Material for Group "Short Term Disability Insurance" and Group "Long Term Disability Insurance" (policyholder's name and rate information redacted), forms IFS-A091258 Ed.3/2005 ECEd.2.2006-1959 EXP.8.2007 and GL.2005.055 Ed.3/2005 ECEd.2.2006-0668 EXP.8.2007
9.Reliance Standard Life Insurance Company Proposal of Service for Group Long Term Disability insurance, provided to employers presale (policyholder's name, broker's name, and rate information redacted)
10.Reliance Standard Life Insurance Company Proposal of Service for Voluntary Disability Income Protection Proposal Summary, for group disability income insurance, provided to employers presale (policyholder's name, broker's name, and rate information redacted)
11.Reliance Standard Life Insurance Company brochure for employees, "Reliance Standard Voluntary Plans Voluntary Disability Income Protection Insurance," form RS 2165 (4/06)
12.Liberty Mutual Group Insurance "Group Benefits" brochure, provided to employers
13.Liberty Mutual Group Insurance "Long Term Disability Insurance" brochure, provided to employers
14.Excerpt from Liberty Mutual Long Term Disability policy, form numbers DOC3-LTD-0003 and DOC3-LTD-0012.05 showing how the monthly benefit is figured, with list of offsets
15.Excerpt from Liberty Mutual Short Term Disability policy, form numbers DOC3-STD-0001 and DOC3-STD-0002.05 showing how the monthly benefit is figured, with list of offsets
16.The Guardian Life Insurance Company of America's marketing materials, forms 2003-6904, Pub 2758N 2003-2269, Pub 27580 2003-2203, 2002-5755,2002-5757, 2002-5756, 2001-21 (12/99), 2002-1680 (3/02), 2002-1681 (3/02), 2002-1677 (3/02), 2002-1678 (3/02), 2002-1679 (3/02), Pub 3255 (8/00) 99-1999, "Sample Short Term Disability Program Benefit Illustration," and "Sample Long Term Disability Program Benefit Illustration"
17.Standard Insurance Company "Voluntary Long Term Disability Insurance" advertisement, form number GP190-LTD/S399, showing how benefits are reduced by offsets, provided to employees

<u>Category Two: E-mails received by the Department of Insurance concerning legal authority.</u> These documents were added to the rulemaking record because they were received, reviewed, and considered by the Department in connection with the regulations.

18.E-mail from Cassie Springer-Sullivan to Nancy Hom dated February 7, 2008 containing legal analysis concerning permanent disability offsets (with names of parties in litigation redacted) and a copy of Carstens v. U.S. Shoe Corporation's Long-Term Benefits Disability Plan (2007) 520 F. Supp.2d 1165
19.E-mail from Cassie Springer-Sullivan to Nancy Hom dated February 19, 2008 containing legal analysis concerning ERISA
20.E-mail from Cassie Springer-Sullivan to Nancy Hom dated February 19, 2008 containing legal analysis concerning involuntary retirement and the Kalvinskas case

<u>Category Three: Settlement Agreement, with Amendment.</u> These documents were added to the

rulemaking record to show that the regulations address certain benefit reduction issues which are included in the Settlement Agreement and that they fulfill the Department's obligation under the Settlement Agreement, as amended, to adopt regulations concerning the subject matter of paragraph 25 of the Settlement Agreement no later than May 19, 2008.

21.Settlement Agreement in Association of California Life & Health Insurance Companies, et al. v. Garamendi, Sacramento County Superior Court Case #05CS01668, dated July 21, 2006, and Amendment to Settlement Agreement in Association of California Life & Health Insurance Companies, et al. v. Garamendi, Sacramento County Superior Court Case #05CS01668, dated July 21, 2006

Category Four: Print-outs from the U.S. Social Security Administration Office website. These materials were added to the rulemaking record so that the record includes specific information about Social Security disability benefits, including information about how many claimants apply to Social Security for disability benefits, what percentage of claims are granted, and how much various claimants receive in terms of dollar amounts of benefits paid.

22. U.S. Social Security Administration Office of Policy Annual Statistical Supplement, 2007 "Old-Age, Survivors, and Disability Insurance" "Benefits Awarded, Disabled Workers, Table 6.C1 Number and percentage distribution, by monthly benefit and sex, 2006, Table 6.C2 Number, average age, and percentage distribution, by sex and age, selected years 1957-2006, and Table 6.C7 Number of applications, awards, ratio of awards to applications, and awards per 1,000 insured workers, selected years, 1960-2006," from www.socialsecurity.gov website

Category Five: E-mail received by the Department of Insurance concerning correction to typographical error in public comments. This document was added to the rulemaking record because it was received, reviewed, and considered by the Department in connection with the regulations.

23.E-mail dated July 31, 2007 from Ted Angelo to Nancy Hom concerning a typographical error in public comments, and Nancy Hom's response dated August 1, 2007

Category Six: Print-outs from the State of California Employment Development Department website. These materials were added to the rulemaking record so that the record contained information from the State of California concerning eligibility for state disability benefits and the benefits themselves.

24.Eight-page print-out from the State of California Employment Development Department www.edd.ca.gov website titled "Disability Insurance" regarding eligibility and benefits.

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UPDATE OF INFORMATION CONTAINED IN INITIAL STATEMENT OF REASONS

The Department's Initial Statement of Reasons remains accurate and is incorporated by reference herein, subject to the following updates:

SPECIFIC PURPOSE AND REASONABLE NECESSITY FOR REGULATIONS:

Section 2232.45.1. Authority and Purpose.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The purpose of section 2232.45.1 as amended is to make the authority and purpose for the regulations clear. Section 2232.45.1 is reasonably necessary to carry out this purpose.

The Department added additional citations to authority (*Calfarm v. Deukmejian* (1989) 48 Cal.3d 805; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216) and referenced CIC section 790.02 in response to public comments. The Legislature and the Courts have given the Commissioner broad rulemaking authority to implement statutes such as CIC section 790.03. CIC 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." CIC 790.03 is in the article to which CIC 790.10 refers. The Commissioner "has broad discretion to adopt rules and regulations as necessary to promote the public welfare." *Calfarm v. Deukmejian* (1989) 48 Cal.3d 805, 824-825. Moreover, the Commissioner's rulemaking authority is implied as well as express. In discussing the Commissioner's powers to establish regulations under Proposition 103, the California Supreme Court stated: "As we made plain in *Calfarm*, the commissioner "may exercise such …powers…as may fairly be implied" from the initiative (Id. At p. 824, 258 Cal. Rptr. 161, 771 P.2d 1247, internal quotation marks and italics omitted.) In our view, the adoption of substantive regulations is one of these powers." *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216 at 280. Given the broad scope of the Commissioner's rulemaking powers and the express delegation of rulemaking authority in CIC 790.10, there is no question that the Commissioner has rulemaking authority to implement the provisions of CIC 790.03. This authority is set forth in section 2232.45.1.

The regulations implement, interpret, and make specific the provisions of CIC section 790.02 and 790.03, which prohibit misleading statements. See CIC 790.03(a) and 790.03(b). The regulations implement, interpret, and make this prohibition specific by prohibiting certain kinds of misleading statements. The regulations would not permit policy provisions to be construed in a manner which is inconsistent with existing law. The regulations would not permit statements by which an insurer unreasonably withholds payments due under a policy by estimating and deducting earnings without a good faith reasonable basis for the calculation of the amount of estimated earnings. The regulations would require more disclosure in advertising statements so that they adequately disclose how a product works. CIC section 790.10 gives the Commissioner rulemaking authority to implement CIC 790.03 by defining what is "misleading." Nothing in CIC 790.10 exempts 790.03 from the broad grant of rulemaking authority given to the Commissioner, and nothing limits the commissioner to defining what is "misleading" on a case-by-case basis in hearings under CIC section 790.06.

Section 2232.45.2. Benefit Reductions Shall Not Be Based on Involuntary Retirement.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The purpose of section 2232.45.2 as amended is to prohibit insurers from estimating and deducting from an insured's maximum benefit amount the amount of retirement benefits, of the kinds specified in section 2232.45.2, that the insured would receive if the insured voluntarily retired. This purpose is achieved by prohibiting policy provisions by which insurers estimate and deduct such amounts when the insured has not voluntarily retired. As made clear in the amendments, the section only applies in situations in which the insured has not voluntarily retired. Nothing in the section prohibits an insurer from deducting the amount of a benefit specified in the section, to the extent the benefit is deductible under existing law, when the benefit has been received by the insured as a result of the insured's voluntary retirement.

The purpose of benefit reductions is to prevent the insured from double-dipping, e.g., receiving a windfall of simultaneous payments of long-term disability benefits and other benefits, such as pension benefits in full. If benefit reductions in the form of offsets were not allowed, a disabled insured could receive more money for lost earnings while disabled than while working. However, when the insured is not eligible to receive pension benefits there is no double-dipping. Hence, section 2232.45.2 prohibits policy provisions which allow insurers to estimate and deduct the certain specified benefits when the insured has not voluntarily retired and is therefore not eligible to receive them. The Department has determined that the regulation is necessary in order to prevent misinterpretation of policy provisions and to establish a uniform rule of general application on this issue. The record contains public comments which support a finding of necessity. [See, e.g., Rulemaking record, Volume 1, Tab N, April 11, 2008 letter from attorney Ron Dean, page 1 item 1; Rulemaking record, Volume 1, Tab O, April 23, 2008 letter from attorney James P. Keenley, pages 1 - 5.] The record also contains insurer materials which can be read as allowing insurers to estimate and deduct certain specified retirement benefits. [E.g., Rulemaking record, Volume 2, Tab E, Reliance Standard Voluntary Plans Disability Income Protection Insurance, page 4]

An insurer should not be allowed to unilaterally determine that an insured is "eligible" for disability-based retirement benefits when the insured has not chosen to retire and receive them, and then offset the amount of such benefits against benefits the insured is entitled to receive under his or her disability income insurance policy. This is inconsistent with the *Kalvinskas* holding on "eligibility" under the ADEA. The *Kalvinskas* case holds that an insured is not "eligible" to receive retirement benefits unless and until he or she has chosen to retire. The court found that the purpose behind allowing the offset at all is to prevent double dipping, i.e., "to prevent an employee from receiving the windfall of simultaneous payments of long-term disability and pension benefits in full." *Kalvinskas*, 96 F.3d 1305 at 1311. When the employee has no right to receive the pension payments because he has not retired, no double-dipping is possible.

The same rationale applies to offsets of disability-based retirement benefits. The purpose of permitting insurers to offset such benefits in the first place is to prevent double-dipping. When double-dipping is not possible because the employee has not retired, there is no rationale to support the offset, other than the insurer's desire to minimize the amount of benefits it is responsible for paying. The Department does not claim that the ADEA applies to non-age-based retirement benefits; it is not "expanding" the ADEA to these situations. Rather, it is applying the rationale supporting the K*alvinskas* decision and allowable offsets in general in a uniform way to the categories of retirement benefits set forth in section 2232.45.2, be they age-based or disability-based.

In addition, with regard to the age-based benefits specified in section 2232.45.2, if an insurer can force the insured to retire and accept age-based benefits, the insured may receive reduced retirement benefit payments as a result of having to claim the benefits earlier rather than later. As noted in the public comments of James P. Keenley, there is a strong public policy supporting the preservation of retirement benefits, evidenced in part by the authorities cited in his April 23, 2008 comments. [Rulemaking Record, Volume 1, Tab O, letter dated April 23, 2008, pages 1-5] This public policy is not served by allowing insurers to estimate and offset retirement benefits and thus force not only retirement, but in some cases the permanent reduction of the insured's age-based retirement benefits.

Section 2232.45.3. Benefit Reductions Shall Not Be Based on Estimated Workers' Compensation Temporary Disability Benefit Not Actually Received by the Insured.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The Initial Statement of Reasons sets forth the purpose of section 2232.45.3. It should also be noted that the Workers' Compensation Appeals Board (WCAB) has exclusive jurisdiction to determine who receives workers' compensation benefits and in what amount. Cal. Labor Code section 5300. Group disability insurance liens specifically come under WCAB jurisdiction through Labor Code subsections 5300(e) and 5300(f), which apply to orders under "Division 4." Division 4 includes lien claims. Group disability insurers are lien claimants under Cal. Labor Code section 4903(c) and Cal. Labor Code section 4903.1. When an insurer estimates the amount of a workers' compensation benefit that an insured would get but which the insured has not received, the insurer is in effect stepping into the shoes of the WCAB. This is inconsistent with the WCAB's exclusive jurisdiction over workers' compensation awards.

If an insured fails to file a claim for workers' compensation, the insurer may initiate that proceeding itself. Cal. Labor Code section 5300(e); 5500; and 8 Cal. Code of Regulations section 10364. Insurers also have resources to investigate claims in order to deal with dishonest or uncooperative claimants. It is inconsistent with the Labor Code for a disability insurer to determine whether there is an injury that is compensable in the WCAB process and to estimate, outside the WCAB process, what the injured person would receive in workers' compensation benefits from the WCAB. Doing so can invite speculation. The fact that a lien increases costs is not sufficient justification for allowing insurers to circumvent the workers' compensation system by estimating what the system would award to their insured and then deducting it from the benefits they pay to the insured. It appears that a general rule, in the form of a regulation, prohibiting provisions which allow estimation and deduction of these benefits is necessary in order to be consistent with the above authorities.

The regulation is necessary to prevent a situation similar to the one described above, in the involuntary retirement context, from occurring in which an insurer estimates and deducts workers' compensation temporary disability benefits when those benefits have not been received by the insured. This can cause great hardship to the insured, who then receives neither temporary workers' compensation benefits nor benefits under his or her disability income insurance policy, and it circumvents California's existing statutory scheme for workers' compensation, which allows the insurer to place a lien on benefits in the insured's workers' compensation proceeding. The necessity for the regulation is evidenced by the public comments of Cassie Springer Sullivan [Rulemaking File Volume 1, Tab I, hearing transcript pages 30:8-31:18] and James P. Keenley [Rulemaking File Volume 1, Tab O, April 23, 2008 public comments, page 7 item 3, where Mr. Keenley states that this regulation is necessary to as not to overburden the Workers' Compensation system with questionable claims filed by disabled people incented to file such claims to avoid a severe reduction in income.]. Examples of language which could be construed to allow offset of estimated workers' compensation benefits are contained in Rulemaking File Volume 2, Tab E: Reliance Standard Voluntary Plans Disability Income Protection Insurance, page 4, and Guardian Product overview Form 2002-1680 (3/02), which use "receive or are eligible to receive" and "receives or is eligible to receive" language.

Section 2232.45.4. Benefit Reductions Shall Not Be Based on Workers' Compensation Permanent Disability.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The Department believes the necessity for the regulation is clear. Because disability income insurance policies are designed to provide a substitute for earnings when, because of injury or disease, the insured is deprived of his capacity to earn a living, "[a] reasonable person would not anticipate that permanent disability benefits under the Workmen's Compensation Act will be deducted from the amount of payment under the disability policy." *Russell v. Bankers Life Co.* (1975) 46 Cal. App.3d 405, 416-417. The comments of Cassie Springer-Sullivan evidence the necessity for the regulation. In her experience, insurers seek to offset permanent disability "100% of the time," and the need for a regulation barring this practice is great. [Rulemaking record, Volume 1, Tab I, hearing transcript, pages 29:4-30:7] Mr. Keenley also stated his support. [Rulemaking record, Volume 1, Tab O, April 23, 2008 letter, pages 6 – 7 item 2.] The record contains insurance company marketing materials which simply refer to reductions in benefits for "workers' compensation," without indicating whether there is any differentiation being made between permanent and temporary workers' compensation benefits. It should be clearer that any such provisions do not encompass permanent workers' compensation benefits. [Rulemaking record, Volume 2, Tab E, The Hartford's Long Term Disability Benefit Highlights (Rev. 1/07) page 3; Rulemaking record, The Hartford's Short Term Disability Benefit Highlights (Rev. 1/07) page 2; Rulemaking record, Volume 2, Tab E, The Prudential Insurance Company of America's informational form IFS-A123674, page 2; Reliance Standard Voluntary Plans Disability Income Protection Insurance, page 4; Standard Insurance Company, Voluntary Long Term Disability Insurance Booklet page 6.] Necessity is also illustrated by Exhibit A to the comments filed by Mr. Keenley on May 2,

2008. Exhibit A is a copy of a U.S. District Court Central District of California Civil Minutes – General in *Alloway v. Reliastar Life Ins. Co. et al.* dated 4/28/08 in which the court denies Reliastar's motion for summary judgment. The case concerns a disability income insurance policy provision allowing offsets for "worker's compensation benefits" and whether this provision would allow offset of workers' compensation permanent disability benefits. Mr. Keenley argues that although this case had the right result based primarily on the employer's actual practice of only offsetting wage replacement income, there is a need for guidance in California concerning the insurer practice of issuing long term disability income policies which allow insurers to offset permanent disability benefits.

The Department agrees that it is good public policy to permit integration of disability benefits to prevent claimants from receiving double recoveries. The purpose of the regulation is to prohibit policy provisions which go beyond this and allow offsets for workers' compensation permanent disability benefits. These provisions would be inconsistent with the law cited in support of this section. The Department seeks to clarify insurers' obligations in this regard.

Section 2232.45.5. Benefit Reductions Based on Earnings Received for Work Performed While Disabled.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The rulemaking record contains evidence that insurers sometimes estimate the amount of an insured's earnings received for work performed while disabled by extrapolating larger amounts of pay from payments received for relatively short periods of work. This does not necessarily reflect the insured's earnings received for work performed. [Rulemaking record, Tab I, hearing transcript, pages 30:8-31:5] A regulation which sets forth that these estimates are subject to a standard of good faith is consistent with California law. The cited authority supports the regulation. Policy provisions which allow such estimates but which are not interpreted in accordance with a duty of good faith are misleading. Statements of estimated earnings must have a good faith reasonable basis. The Department believes that the regulation is a simpler way of interpreting CIC 790.03's requirements than seeking legislation. The Department believes the regulation is reasonably necessary to obtain more accuracy in estimates of earnings received for work performed while disabled, and as an effort to prevent misleading estimates.

Section 2536.2. Advertisements of Benefits Payable, Losses Covered or Premiums Payable.

This section has been amended as set forth above in the Updated Informative Digest, for the reasons set forth above. The necessity for this regulation is evidenced by the public comments in the record that say the public is not adequately informed of offsets. [e.g., Rulemaking record, Volume 1, Tab I, hearing transcript pages 31:19-32:25; Rulemaking record, Volume 1, Tab I, hearing transcript pages 64:13-65:5]. Necessity is also shown by the insurers' marketing materials that are made part of the rulemaking record. [Rulemaking record, Volume 2, Tab E] These materials do not adequately explain to the public the extent to which various offsets reduce the benefit that is actually received by the insured. Some materials do not mention offsets at all, yet the policy forms contain offsets which operate to reduce the benefits an insured could receive. Others refer to "benefit integration" and "coordina(ion) with other income benefits" for "other sources of income an insured receives or is eligible to receive." [Rulemaking record, Volume 2, Tab E, Reliance Standard Life Insurance Company Group Long Term Disability Proposal of Service March 29, 2007, pages LTD-3 and LTD-8] While this is understood within the industry, it is not clear to the public. The Department included the marketing materials of Standard Insurance Company as an example of how it is possible, without too much burden, to disclose how offsets reduce benefits. That is the sort of disclosure the regulations would require. [Rulemaking record, Volume 2, Tab E, the page numbered "3"]

The fact that the insurers will incur some expense in revising their materials does not outweigh the detriment to the public of not understanding the coverage offered or provided. The Hartford notes that these products are not understood by the public in its marketing study titled "Unintended Exposure: The surprising 'Big Gamble' Employees Take Every Day," page 8, "Why should employees buy coverage when they don't even understand what it does?" [Rulemaking record, Volume 2, Tab E, The Hartford's Disability Literacy Study]

The Department believes that the regulation is necessary in order for the public to better understand the potentially huge impact that offsets can have on benefits actually received. It is irrelevant whether an employer or employee pays for the coverage – both are entitled to better disclosure. It is also irrelevant whether employers choose to create their own descriptive materials. Insurers' materials must disclose material information as well, and better disclosure by insurers can only further better disclosure by employers.

UPDATE OF MATERIAL RELIED UPON

No material other than the public comments, the transcript of the public hearing, the two Notices of Availability of Revised Text, the two Amended Texts of Regulation made available for 15-day notice, the Notice of Addition to Rulemaking File and the documents listed therein, the Declarations of Mailing therefore, this Final Statement of Reasons, the Final Text of Regulations, the executed Form 400, and the Certification of the rulemaking record has been added to the rulemaking file since the time the rulemaking record was opened, and no additional material has been relied upon.

IDENTIFICATION OF STUDIES

The Department relied upon the portions of The Hartford insurance company's marketing study cited herein. The study is titled "Unintended Exposure: The surprising 'Big Gamble' Employees Take Every Day," With that exception, there are no technical, theoretical, and empirical studies, or similar documents relied upon in proposing the adoption of the regulations.

MANDATE UPON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Department has determined that the proposed regulations will not impose a mandate upon local agencies or school districts.

ALTERNATIVES

The Commissioner has determined that there are no alternatives that would be more effective, or as effective and less burdensome to affected persons, than the proposed regulations. Although some public comments state that the Department should proceed by way of legislation rather than regulation, the Commissioner has determined that it is more appropriate to address the issues at hand by issuing regulations which clarify insurers' obligations under CIC section 790.03. Moreover, the Commissioner is obligated to adopt regulations concerning the subject matter of sections 2232.45.2, 2232.45.4, and 2232.45.5 by the terms of the Settlement Agreement in *ACLHIC et al. v. Garamendi and the California Department of Insurance*, Sacramento County Superior Court case number 05CS01668, as amended, no later than May 19, 2008. The Settlement Agreement, and the Amendment thereto, is included in this rulemaking file.

ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE:

The Department received public comments stating that the regulations will increase insurers' costs and therefore increase the cost of coverage to the public. Insurers may or may not decide to charge more for their products as a result of the regulations. The regulations make the products being sold more valuable, because the regulations require that the products provide better coverage. Therefore, even if an insurer chose to increase premium as a result of the regulations, the cost to the consumer may be unchanged, because the consumer receives better coverage as a result of the regulations.

SUMMARY OF AND RESPONSE TO COMMENTS

Commenter	Synopsis or Verbatim Text of Comments	Response
	COMMENTS ON THE ORIGINAL VERSION OF THE PROPOSED REGULATIONS, WHICH WAS THE SUBJECT OF THE JULY 10, 2007 PUBLIC HEARING	
Ted M. Angelo, ACLHIC; John Mangan, ACLI, letter dated 7/10/07 [Tab G]: Verbatim text of letter, with synopsis of hearing testimony added where testimony is in addition to, and not duplicative of written comments. Hearing testimony is indicated by brackets and the letter "T." Gene Livingston, attorney for ACLHIC and	This letter is submitted on behalf of the American Council of Life Insurers and the Association of California Life and Health Insurance Companies, whose members write the majority of disability income insurance in the United States and California. We appreciate the opportunity to comment on the above-captioned proposals. (1) Generally, we do not believe the commissioner has the authority to promulgate these rules under Insurance Code section 790.03 and 790.10. [T 7-10: Section 790.10 authorizes CDI to adopt regulations to implement section 790.03 but it does not authorize CDI to create additional unfair business practices via regulations. This must be done by hearing under section 790.06. The regulations don't implement existing unfair business practices in 790.03.] (2) [T 10-11: There is no showing of necessity. The record has no evidence that companies are engaging in an unfair business practice.] (3) **Comments to Proposed Regulation 2232.45.1 and 2232.45.2 (Retirement Benefits)** **Benefit Reductions Based on Estimated Retirement Awards.** The language of proposed regulation 2232.45.2 is overbroad and inconsistent with the California Department of Insurance (the Department) explanation of intent as presented in the Summary of Existing Law; Effect of Proposed Action, section 2232.45.2, entitled "Benefit Reductions Shall Not be Based on Involuntary Retirement."	(1) The Department added additional citations to authority (*Calfarm v. Deukmejian* (1989) 48 Cal.3d 805; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216) and referenced CIC section 790.02 in response to this comment. The Legislature and the Courts have given the Commissioner broad rulemaking authority to implement statutes such as CIC section 790.03. CIC 790.10 states: "The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article." CIC 790.03 is in the article to which CIC 790.10 refers. The Commissioner "has broad discretion to adopt rules and regulations as necessary to promote the public welfare." *Calfarm v. Deukmejian* (1989) 48 Cal.3d 805, 824-825. Moreover, the Commissioner's rulemaking authority is implied as well as express. In discussing the Commissioner's powers to establish regulations under Proposition 103, the California Supreme Court stated: "As we made plain in *Calfarm*, the commissioner "may exercise such …powers…as may fairly be implied" from the initiative (Id. At p. 824, 258 Cal. Rptr. 161, 771 P.2d 1247, internal quotation marks and italics omitted.) In our view, the adoption of substantive regulations is one of these powers." *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216 at 280. Given the broad scope of the Commissioner's rulemaking powers and the express

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ACLI, and Larry Frank, attorney for Standard Insurance Co., presented most of ACHLIC's and ACLI's comments at the hearing, with John Mangan adding comments. The inserted parenthetical numbers are keyed to responses.	The Department indicates its intent is to prohibit disability income policy provisions that force employee retirement by reducing or eliminating benefits through the use of estimated retirement benefit offsets. However, the actual language of the regulation appears to prohibit estimating any amount of benefits the insured might receive under a program for retirement, even if the employee can apply and receive the retirement benefits while working. For example, normal retirement age benefits under Social Security. A disability claimant who is at or past normal retirement age may be eligible to receive SSA retirement benefits (and for some reason, not apply for it) regardless of whether they are retired or working. In this circumstance, estimating a benefit under the SSA's retirement program would not result in a "forced retirement" as described by the Department because the person may continue to work and apply and receive the SSA retirement benefit. Thus, the current proposed regulation is overbroad and would prevent offsetting an estimated retirement benefit that does not force retirement of the insured. Page 2 of 7 (4) In addition, this proposed regulation is unnecessary and, in part, (5) without legal authority. As the comments to the regulation note, there are already legal restrictions imposed by the Age Discrimination in Employment Act (ADEA) upon the right to estimate retirement benefits when entitlement to those retirement benefits is based entirely on age. However, the proposed regulations do not merely reiterate what was held by the Court in the *Kalvinskas* case, they expand that holding without legal authority. Subsections (a), (d) and (e) of this proposed regulation deal with retirement benefits that an insured is eligible for based on his or her age. Accordingly, the ADEA already regulates the problems these subsections are intended to address. [T 13-14: *Kalvinskas* relied upon 29 USC	delegation of rulemaking authority in CIC 790.10, there is no question that the Commissioner has rulemaking authority to implement the provisions of CIC 790.03. The regulations implement, interpret, and make specific the provisions of CIC section 790.02 and 790.03, which prohibit misleading statements. See CIC 790.03(a) and 790.03(b). The regulations implement, interpret, and make this prohibition specific by prohibiting certain kinds of misleading statements, such as policy provisions which are inconsistent with existing law, statements by which an insurer unreasonably withholds payments due under a policy by estimating and deducting earnings without a good faith reasonable basis for the calculation of the amount of estimated earnings, and advertising statements which do not adequately disclose how a product works. If the commentators' position is correct, then the Commissioner has no rulemaking authority to implement CIC 790.03 by defining what is "misleading." This is incorrect as a matter of law. Nothing in CIC 790.10 exempts 790.03 from the broad grant of rulemaking authority given to the Commissioner. The Commissioner is not restricted to defining what is "misleading" on a case-by-case basis in hearings under CIC section 790.06. (2) No change. The record contains numerous illustrations of the necessity for the regulations, as set forth herein and in the Updated Initial Statement of Reasons, above. Several commentators (Cassie Springer-Sullivan, John Metz, James P. Keenley, and Ron Dean) have said there is necessity for the proposed regulations. The record contains supporting material indicating that some companies may interpret existing law as allowing

Commenter	Synopsis or Verbatim Text of Comments	Response
	623 (f)(2)(B), which states that “No such employee benefit plan shall require or permit the involuntary retirement of any individual specified by section 631(a) of this title because of the age of the individual,” in holding that a company’s estimation and deduction of benefits the plaintiff would have been eligible to receive was not permitted under that statute. But the ADEA permits a long-term disability benefit plan to offset benefits that a disabled claimant would be eligible to receive if they attain the age of 62 or normal retirement age, whichever is later, under 29 USC 623 (1)(f)(3). The regulation proposes an outright ban on deducting normal age retirement benefits under *Kalvinskas*, which is based on the ADEA and that’s not what the ADEA provides.] (5) In contrast, in subsections (b) and (c), the proposed regulations purport to impose restrictions with respect to offsets for disability retirement benefits. While those terms are undefined, most such plans allow benefits not based on age, but based on meeting a test of disability. The ADEA [T 15: and *Kalvinskas*] is not applicable to these situations because there is no age-based classification involved. The Commissioner cites no legal authority for expanding the effect of the ADEA to these situations. When a carrier finds that an insured is eligible for benefits from a retirement plan to replace income lost due to a disability, a carrier should have the right to use an estimated offset for those benefits if: (a) the insured chooses not to apply for or pursue those disability retirement benefits, (b) the policy notifies the insured of his or her obligation to pursue those benefits, and (c) the carrier has a reasonable means of estimating the amount payable. [T 15-16: It is imperative that we be able to integrate other disability benefits. There could be protections for the consumer, such as no estimating and deducting so long as the individual has applied and is reasonably diligently seeking those benefits, and that the carrier have a reasonable basis to believe the individual	them to: estimate and deduct retirement benefits before insureds have voluntarily retired (section 2232.45.2); offset estimated workers’ compensation temporary disability benefit amounts outside the statutory framework for recovering these amounts via liens in workers’ compensation proceedings (section 2232.45.3); offset workers’ compensation permanent disability benefits (section 2232.45.4); estimate and offset amounts for work performed by the insured while disabled, even when such calculations lack a good faith reasonable basis (section 2232.45.5); and issue advertising materials to purchasers and insureds which do not disclose the extent to which offsets may reduce the benefits an insured could receive. The companies’ use of offsets and the necessity for further disclosure in advertising is shown by the companies’ advertisements. The Standard Insurance Company’s brochure shows that the kind of additional disclosure required by the amendments to section 2536.2 can be implemented. [Rulemaking Record, Volume 2, Tab E] (3) The Department amended the regulation in response to this comment by adding clarifying language. This comment misunderstands the regulation and the circumstances in which it applies. The regulation applies when the insured is entitled to receive benefits under his or her disability income insurance policy because he or she has become disabled and is not able to work. (The definition of total disability in California provides that the insured is totally disabled when he or she is “unable to perform with reasonable continuity the substantial and material acts necessary to pursue his usual occupation in the usual or customary way or to engage with reasonable

Commenter	Synopsis or Verbatim Text of Comments	Response
	is eligible for those benefits and be able to calculate the amount. But an outright ban is not supported by law, is not good public policy, and will impact the cost of coverage.] (6) The Commissioner must acknowledge that an insured has a duty to mitigate his or her damages. When an insured is eligible for a retirement benefit because of disability, but for whatever reason chooses not to apply for or diligently pursue those benefits, an insurer should have the right to estimate those benefits. There is no legal authority that prohibits estimating an offset for disability retirement benefits. Failing to recognize the strong public policy requiring a party to a contract to mitigate their damages would unnecessarily result in increased costs for California employers and employees seeking group disability income insurance. (7) This provision is not really necessary at all, given that existing federal law (ADEA and the Older Worker's Benefit Protection Act, as interpreted in the 9th Circuit by *Kalvinskas*) already addresses the issue. (8) Still, we would not find the provision objectionable if it were consistent with the court's holding in *Kalvinskas.* At a minimum, the provision should be modified by striking "voluntary" from line 2, and by removing Social Security and PERS from the list of benefits affected. The Department's stated basis for this provision is to enforce *Kalvinskas*; but the proposed regulation goes farther in two respects. First, *Kalvinskas* interprets a provision in the Older Worker's Benefit Protection Act which regulates offsets with employer-sponsored pension plans only. It does not purport to regulate offsets against Social Security normal retirement age benefits or other public sector programs. Most LTD plans do in fact terminate benefits for most employees at normal retirement age. There is no good reason why a plan should not be able to provide for continued payment of benefits subject to offset for	continuity in another occupation in which he could reasonably be expected to perform satisfactorily in light of his age, education, training, experience, station in life, physical and mental capacity." *Moore v. American United Life Ins. Co.* (1984) 150 Cal. App.3d 610 at 632.) Therefore, the comments premised upon the insured's working are irrelevant. Moreover, the comment is premised on defining "eligible" in a way that is contrary to the *Kalvinskas* decision. In *Kalvinskas*, the insured did not become "eligible" to receive retirement benefits until he voluntarily chose to retire. In addition, the portion of the comment that is based on the insured receiving social security benefits is irrelevant to the regulation. The regulation only pertains to situations in which the insured is not receiving the retirement benefit specified because they have not chosen to retire and thus are not eligible to receive such benefits. Under these circumstances, if the insurer estimates and deducts benefits for which the insured is not eligible, the insurer is may be forcing the insured's retirement. This would be contrary to *Kalvinskas* and misleading. Nevertheless, the Department amended the regulation to clarify these points and address the commentator's concerns by adding language that makes it clear that the regulation applies only to involuntary retirement situations in which the insured is not receiving retirement benefits. (4) The Department added additional citations to authority (*Calfarm v. Deukmejian* (1989) 48 Cal.3d 805; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216) and referenced *Gruenberg v.Aetna Insurance Company*

Commenter	Synopsis or Verbatim Text of Comments	Response
	estimated Social Security normal retirement age benefits or PERS benefits payable at normal retirement age, when it is permissible to terminate benefits entirely at normal retirement age. Moreover, there are means by which the amount of these benefits can be estimated with a high degree of confidence. Second, *Kalvinskas* only addressed the issue of whether an *estimated* offset for employer sponsored retirement benefits itself constituted forced retirement, in cases where the employee had to retire in order to receive the estimated retirement benefit. Page 3 of 7 Finally, if an individual is eligible for disability benefits under a public or private retirement plan, an insurer should have the right to estimate those disability benefits for which they are eligible and offset disability benefits by that amount. There should be a distinction between benefits a retirement plan pays for retirement versus what it pays for disability. Any loss of time benefit paid out for the disability from another plan should be deductible from the group disability plan to avoid double recovery for that loss. **Comments to Proposed Regulation 2232.45.3 (Workers' Compensation - Temporary)** (9) This proposed regulation is unnecessary and (10) overly broad. (9) The apparent purpose of this regulation is to prohibit group disability insurers from offsetting estimated amounts of workers' compensation benefits when those benefits are being disputed. In those cases where workers' compensation is disputed, industry practice is to pay disability benefits without any offset and pursue recovery of any potential overpayment through the lien process. Thus, the regulation is unnecessary.	(1973) 9 Cal.3d 566; *Smith v. Alum Rock Union Elementary School District* (1992) 6 Cal. App. 4th 1651; and CIC section 790.02 in response to this comment. As set forth above, the record evidences necessity for the proposed regulation. The ADEA and the *Kalvinskas* decision do not obviate the need for the regulation, and the regulation is not inconsistent with these authorities. The exception miscited by the commentator as 29 USC 623 (1)(f)(3) applies when the claimant is *eligible* to receive the retirement benefits. As discussed below in response (5), eligibility is contingent upon the claimant's voluntary decision to retire. This is consistent with the regulation, which allows offsets in voluntary retirement situations but prohibits provisions which allow estimated offsets in involuntary retirement situations. The regulation provides a needed nexus between the *Kalvinskas* holding and policy language which would comply with the requirements of CIC section 790.03. (5) No change. The Department does not claim that the ADEA applies to non-age-based retirement benefits; it is not "expanding" the ADEA to these situations. However, this does not mean that the insurer may therefore unilaterally determine that an insured is "eligible" for disability-based retirement benefits when the insured has not chosen to retire and receive them, and then offset the amount of such benefits against benefits the insured is entitled to receive under his or her disability income insurance policy. This is inconsistent with the *Kalvinskas* holding on "eligibility" under the ADEA. The *Kalvinskas* case holds that an insured is not "eligible" to receive retirement benefits unless and until he or she has chosen to retire. The court found that the purpose behind

Commenter	Synopsis or Verbatim Text of Comments	Response
	(10) Furthermore, the regulation is overly broad because it is not limited just to the circumstance where the insured has diligently pursued workers' compensation benefits and the claim for workers' compensation benefits is pending. It would also prohibit an insurer from offsetting workers' compensation benefits in those situations where the insured fails to provide adequate notice of an accident that would give rise to a claim or fails to cooperate with the workers' compensation carrier's claim requirements. [T 16: The regulation is an absolute ban against ever estimating and deducting. It's not limited to any set of circumstances.] The duty of good faith runs both ways in an insurance contract and the insured has a duty to mitigate his or her damages. If an insured chooses to not pursue a claim for workers' compensation for which he or she is eligible and would be entitled had the insured diligently pursued that claim, the disability insurance carrier should not bear the burden. Instead, in that circumstance, sound public policy supports allowing the insurance company to reduce the insured's claim by that amount. There is no legal authority for the Commissioner to prohibit parties from agreeing to recognize that public policy. [T 17: This is probably something that should be done in a different context than regulations.] (11) The language of proposed regulation 2232.45.3 is incomplete and will result in double recovery for the dishonest or uncooperative claimant. The proposed regulation misinterprets *Silberg v.California Life Insurance Co.* The issue in that case was not that the insurer estimated workers' compensation benefits, but that the insurer did not have a good faith basis for doing so, given that the claimant's eligibility for workers' compensation was being contested. Where there is a good faith basis for believing a claimant is eligible for workers' compensation benefits and for estimating the amount of benefit due, a carrier should have the ability to offset. Asserting a lien	allowing the offset at all is to prevent double dipping, i.e., "to prevent an employee from receiving the windfall of simultaneous payments of long-term disability and pension benefits in full." *Kalvinskas*, 96 F.3d 1305 at 1311. When the employee has no right to receive the pension payments because he has not retired, no double-dipping is possible. The same rationale applies to offsets of disability retirement benefits. The purpose of permitting insurers to offset such benefits in the first place is to prevent double-dipping. When double-dipping is not possible because the employee has not retired, there is no rationale to support the offset, other than the insurer's desire to minimize the benefits it is responsible for paying. The commentator states that when an insured is "eligible" for a retirement benefit because of disability, but does not apply for it, the insurer should have the right to estimate and offset that benefit. The commentator offers no authority to support this definition of "eligibility." This way of defining "eligibility" is inconsistent with the way the K*alvinskas* court defined "eligibility" under the ADEA and inconsistent with the rationale for allowing offsets, age-based or otherwise. For the age-based benefit categories listed in section 2232.45.2, if the insurer can force the insured to retire, the insured may receive reduced retirement benefit payments as a result of having to claim the benefits earlier rather than later. As the marketing materials in the record reveal, this is not made clear to the public. As noted in the public comments of James P. Keenley,

Commenter	Synopsis or Verbatim Text of Comments	Response
	is inefficient as it increases costs. (12) To avoid this result, we suggest that a workable solution would allow for estimated offsets where: (1) the claimant has failed to pursue this benefit with reasonable diligence; (2) the carrier has a reasonable good faith belief that the claimant is entitled to such benefit and a reasonable means of estimating the amount payable; or (3) the carrier has a good faith belief that the claimant has received or is receiving temporary workers' compensation benefits, and (4) the claimant fails to provide information reasonably requested by the carrier in relation to application for, or receipt of, workers' compensation benefits. Without the requested change, the honest and diligent insured will be penalized in comparison to the dishonest and uncooperative claimant. In addition, the effect of the overpaid claims will harm the plan, the plan sponsor and current and future participants in the form of higher premium rates. [T 18: It will preclude integration of other disability benefits, which will drive up the cost of coverage and create overinsurance problems.] We would be willing to discuss this issue further with the Department. Page 4 of 7 **Comments to Proposed Regulation 2532.45.4 (Workers' Compensation – Permanent)** (13) This proposed regulation would prohibit a group insurance policy from including an offset for permanent workers' compensation benefits. The cited authority does not provide a valid basis for the proposed regulation. (15) Furthermore, the regulation would also encourage structuring workers compensation payments to avoid any offset. (13) The comments accompanying the proposed regulation cite to *Russell v. Bankers Life Co.*, (1975) 46 Cal. App. 3d 405. This proposed regulation misinterprets this decision, which did not hold that the offset was contrary to public policy, or	there is a strong public policy supporting the preservation of retirement benefits, evidenced in part by the authorities cited in his April 23, 2008 comments. [Rulemaking Record, Volume 1, Tab O, letter dated April 23, 2008, pages 1-5] This public policy is not served by allowing insurers to estimate and offset retirement benefits and thus force not only retirement, but in some cases the permanent reduction of the insured's retirement benefits. It is unclear why it is "imperative" for the commentator to be able to integrate disability benefits that have not been received by the insured because the insured is not eligible for them. The consumer protections suggested by the commentator would allow estimated offsets to continue, and therefore would be inconsistent with the authorities and the public policy considerations above. The regulations do not impose a blanket prohibition on the offsets specified. Section 2232.45.2 implements, interprets, and makes CIC section 790.03's prohibitions on misleading statements specific so that policy provisions which permit the offset of benefits that the insured is not eligible to receive are not permissible. (6) No change. This is not an issue of the insured's failure to mitigate damages – in this analogy the insured's lost earnings are the "damages." Instead, it is a determination of which entity is responsible for insuring against those lost earnings, and what portion of the lost earnings they are obligated to pay to the insured in the form of benefits. If the commentator were correct on this point, mitigation of damages would have nothing to do

Commenter	Synopsis or Verbatim Text of Comments	Response
	inappropriate in all cases. It held only that the policy language in question did not clearly allow for the offset. The Department's stated rationale – that permanent benefits cover the employee's working capacity through retirement age – is in fact the best argument for allowing this offset, as most LTD policies are covering the same risk. Allowing the offset to the extent that the award is attributable to the period for which benefits are payable under the disability policy is consistent with the Department's stated rationale. Failure to allow this offset results in situations where an LTD benefit, which pays a benefit through normal retirement age, is unable to take into account the workers' compensation award covering the same period of disability. The *Russell v. Bankers Life Co.* case does not stand for the blanket proposition that permanent workers' compensation benefits cannot be offset under California law. Instead, the Court ruled that the insurer could not offset the workers' compensation settlement at issue for two reasons. First, there was a conflict between the terms of the group policy and the booklet outlining the coverage that had been provided to the insured. Second, the Court found that the particular policy language was ambiguous about whether the phrase "loss of time" was intended to modify the offset for workers' compensation benefits. The holding of the *Russell* case cannot be expanded beyond the particular facts and particular policy language at issue in that case. [T 19-21: The *Russell* case determined that the language was ambiguous with respect to permanent workers'compensation disability, and then they drew a distinction between temporary and permanent workers' comp. But it wasn't a legal ban prohibiting offsets for permanent workers' compensation benefits. In fact, the court stated at page 416: "Absent the modification by the term 'loss of time from employment' the disability here would encompass both types of disability classifications as coverages to be excluded." If the policy were clear enough it could have an	with the insured's lost earnings, but rather would be the extent to which the insurer could mitigate its own "damages," through "estimating" benefits and forcing retirement so that entities other than the insurer would be required to pay benefits equal to a certain portion of the insured's lost earnings. Moreover, as noted above, the commentator's comment is premised upon its use of a definition of "eligible" that is inconsistent with the ADEA, the *Kalvinskas* case, and the rationale behind allowing offsets to begin with. (7) No change. Necessity is demonstrated by the public comments in the record stating that this kind of provision is necessary. The insurers' marketing materials can be read to encompass estimated offsets. [See, e.g., Rulemaking Record, Volume 2, Tab E, The Hartford's Benefit Highlight Sheets: "Disability Benefit Highlights" which allows offsets for certain specified benefits that "you receive or are eligible to receive." See also, Reliance Standard Voluntary Plans Disability Income Protection Insurance, page 4, also using the same language concerning offsets that "you receive or are eligible to receive." The industry's definition of "eligible," as evidenced in its public comments, allows estimated offsets. The Prudential's custom enrollment material for Group "Long Term Disability Insurance" is less specific. It simply states, "Your monthly LTD benefits will be 60% of your monthly earnings (excludes bonuses and/or commissions), up to the maximum of $10,000, *less deductible sources of income* (emphasis added)." [Rulemaking Record, Volume 2, Tab E] (8) The Department amended the regulation in response

Commenter	Synopsis or Verbatim Text of Comments	Response
	exclusion for permanent workers'compensation. It is good public policy to permit integration of other mandated disability benefits when you're trying to provide this kind of comprehensive coverage.] The comments also reference Cal. Labor Code 4903.1(a)(3). That statute recognizes that a disability insurer would have a lien against any payments of temporary workers' compensation payments to the extent of disability income insurance benefits received. This is not sufficient legal authority to prohibit any offset for permanent benefits. The fact that the legislature created a remedy for disability insurers but limited the remedy to temporary workers' compensation benefits cannot be reasonably construed as an outright prohibition on an offset for permanent workers' compensation benefits. (14) Further, the comments do not assert the Commissioner has legal authority to issue this regulation on the grounds that an offset for permanent workers' compensation benefits is an unfair trade practice. Instead, the Commissioner asserts that he has authority to make the definition of unfair trade practices more specific. However, the Insurance Code specifically defines unfair trade practices in Cal. Ins. Code 790.03. Offsetting permanent workers' compensation benefits is not included within those definitions. The only statutorily authorized way for the Commissioner to specify conduct as an unfair trade practice is through an administrative complaint and a hearing as described in Cal. Ins. Code 790.06. The Commissioner cites no such ruling and we are not aware of any. Accordingly, the Commissioner is without authority to issue a regulation applicable to permanent workers' compensation benefits. Page 5 of 7 (15) Finally, limiting an insurer's right to offset only temporary workers' compensation benefits will result in a windfall to an	to a portion of these comments. The regulation has always been consistent with the K*alvinskas* decision. It is unclear why the commentator suggests that the word "voluntary" be removed. By removing the voluntary component from the regulation the regulation would become inconsistent with *Kalvinskas.* The Department did not remove public benefits from the list of benefits in the regulation because public benefits are subject to the same treatment. See *Smith v. Alum Rock Union Elementary School District* (1992) 6 Cal. App.4th 1651, which concerns public benefits, and which has been added to the list of reference authority for this section. Most long term disability plans do terminate at a normal retirement age, and therefore applicability of the regulation will not be an issue once the plan terminates. However, for the fewer instances in which the insurer chooses to provide coverage after normal retirement age, the commentator has not provided any authority to explain why a different analysis should apply, other than simply saying there is "no good reason" to do so when the insurer doesn't have to provide such coverage to begin with. This is insufficient to support a different rule for these situations, given all of the considerations set for the above. In addition, the assertion that estimates can be made "with a high degree of confidence" is irrelevant. If forced retirement is not permitted, estimates are not made. The Department amended the regulation to make clear that it concerns *estimated* benefits. It does not prohibit an insurer from deducting the amount of a benefit listed, to the extent the benefit is deductible under existing law, when the benefit has been received by the insured as a

Commenter	Synopsis or Verbatim Text of Comments	Response
	insured and possible additional litigation. When workers' compensation benefits are disputed, the parties frequently agree to a compromise settlement. If a disability insurer only has the right to offset temporary workers' compensation benefits, the settlement is likely to be structured to recite that the benefits are for permanent benefits or for medical expenses. The intent of such a settlement would be that the disability insurer would be deprived of its right to offset all or a portion of the lump sum the insured received from the workers' compensation carrier. If such a settlement is allowed, the insured would receive windfall disability income insurance benefits without an offset and a payment of what is essentially temporary workers' compensation benefits. To avoid such a result, a disability carrier would be forced to intervene in the workers' compensation matter to protect its interest and litigate in the event that such a settlement is attempted. This could delay workers' compensation payments, place additional burdens on the workers' compensation system, and result in increased costs for the disability insurance carrier that may be passed along to the policyholder and employees in the form of increased rates. We request that this provision not be adopted. **Comments to Proposed Regulation 2532.45.5 (Work Earnings)** (16) This proposed regulation appears unnecessary and the cited authority does not support the authority of the Commissioner to issue it. This proposed regulation would require an insurer to have a good faith basis for estimating earnings that would be the subject of an offset. However, an insurer's duty of good faith is already implicit in the insurance relationship. The Commissioner has failed to provide any evidence that violations of this duty occur so frequently as to make this regulation necessary. We request this section be deleted. [T 21: We don't have any quarrel with the regulation's articulation of the law.	result of the insured's voluntary retirement. However, as discussed above, an individual is not "eligible" to receive the benefits if they have not voluntarily retired, and for the reasons set forth above, the Department did not distinguish between age-based and disability-based benefits, or public and private benefits. (9) No change. The regulation is necessary to prevent a situation similar to the one described above in the forced retirement context from occurring when an insurer estimates and deducts workers' compensation temporary disability benefits when those benefits have not been received by the insured. This can violate the insurer's duty of good faith towards the insured; it can cause great hardship to the insured, who then receives neither temporary workers' compensation benefits nor benefits under his or her disability income insurance policy; and it circumvents California' existing statutory scheme for workers' compensation, which allows the insurer to place a lien on benefits in the insured's workers' compensation proceeding. The necessity for the regulation is evidenced by the public comments. [Rulemaking file Volume 1, Tab I, hearing testimony of attorney Cassie Springer-Sullivan pp. 30:8 – 31:18; Rulemaking file Volume 1, Tab O, April 23, 2008 letter from attorney James P. Keenley, p. 7, item 3.] The insurance marketing materials in the file which permit offsets of estimated amounts also indicate the necessity for a regulation which addresses this issue. (10) No change. Again, the commentator confuses the insured's duty to mitigate damages with the insurers' desire to reduce their liability for payment of claims. If an

Commenter	Synopsis or Verbatim Text of Comments	Response
	We are bound by good faith standards, which is why the regulation is unnecessary. We are open to working with you in the context of legislation on this topic.] **Comments to Proposed Regulation 2536.2(b)(4) (Advertisements)** (17) While we support the premise that the existence and effect of offsets should be made clear in conjunction with description of the amount of benefit payable, we believe the regulation goes too far in requiring advertisements to contain specific illustrative examples. Examples are not necessary to make the effect of offsets clear, and in some cases may be a more confusing way of presenting the information to the consumer. In addition, the proposed regulation would create a burdensome requirement that would be expensive and difficult to satisfy. These additional costs would be ultimately born by California employers and employees. Further, as it is currently drafted, the proposed regulation is ambiguous regarding the scope of its applicability. The proposed regulation ignores that most group disability insurance is offered by and through employers, who very often will create their own descriptive materials. In fact, employers will create their own descriptive materials if they consider the materials provided by the carrier to be too cumbersome. In our experience, carrier-created materials are most readily accepted by employers when they are clear and brief. The requirement of disclosing each possible reduction of benefits, the circumstances when each reduction applies and including an example of each of those reductions would impose a significant, impractical burden and transform advertisements	insured fails to file a claim for workers' compensation, the insurer may initiate that proceeding itself. Cal. Labor Code section 5300(e); 5500; and 8 Cal. Code of Regulations section 10364. The Workers' Compensation Appeals Board (WCAB) has exclusive jurisdiction to determine who receives workers' compensation benefits and in what amount. Cal. Labor Code section 5300. Group disability insurers are lien claimants under Cal. Labor Code section 4903(c) and 4903.1. It is inconsistent with the Labor Code for a disability insurer to determine whether there is an injury that is compensable in the WCAB process and to estimate, outside the WCAB process, what the injured person would receive in workers' compensation benefits from the WCAB. Doing so can invite speculation. It appears that a general rule, in the form of a regulation, prohibiting provisions which allow estimation and deduction of these benefits is necessary in order to be consistent with the above authorities. The regulation prohibits such policy provisions on the grounds that they are misleading to the public. (11) No change. Insurers have resources to investigate claims in order to deal with dishonest or uncooperative claimants. They may also initiate a workers' compensation proceeding themselves, if necessary, and they have the right to file a lien in that proceeding to recover an offset. Cal. Labor Code section 5300(e); 5500; and 8 Cal. Code of Regulations section 10364. The fact that a lien increases costs is not sufficient justification for allowing insurers to circumvent the workers' compensation system by estimating what the system would award to their insured and then deducting it from

Commenter	Synopsis or Verbatim Text of Comments	Response
	from a brief description of the product into a detailed description of claims process, more lengthy than the applicable policy provisions themselves. [T 22: There could be a dozen different offset situations, with varying circumstances for each person, which would require a document having 40 to 50 examples or more to try to illustrate the effect of offsets as required by the regulation.] Because factual claim situations vary by individual, how the offset ultimately applies in any given situation will vary. Page 6 of 7 Furthermore, the proposed regulation could be interpreted to apply to many different types of advertising. The regulation applies to any advertisements for the policy when a group disability income insurance policy contains a provision which reduces the benefit payable. "Advertisements for the policy" are not defined, which will lead to speculation and conjecture about the types of advertisements to which these requirements would be applicable. The current advertising regulations divide the types of advertising into three categories: (1) institutional advertisements; (2) invitations to inquire; and (3) invitations to contract. These are defined in 10 CCR 2535(g)-(i). Other existing regulations are drafted with reference to these categories. For example, 10 CCR 2526.2(b)(1) is limited to an advertisement which is an invitation to contract. By not being similarly restricted, the proposed regulation is unclear about its scope and applicability. [T 23-25: Institutional advertisements as defined in the CCR section 2535.3(b) guideline are very brief and don't even get into the details of coverage. It is inappropriate to require detailed description of one thing in these advertisements. Also, invitations to inquire are also brief – very short description advertisements, They don't go more than a page and a half because they have to be brief. The regulation requires too much	the benefits they pay to the insured. (12) No change. The commentators' suggested criteria are all determinations made by the insurer, and tend to lack bright line rules (the insurer will decide "reasonable diligence," "reasonable good faith belief," "reasonably requested," etc.). There is insufficient evidence that requiring an insurer to offset pursuant to an amount determined in a workers' compensation proceeding, as opposed to its own "estimated" amount" of temporary workers' compensation benefits, will preclude integration of other disability benefits, and lead to overinsurance, overpaid claims, harm to the plan, and unacceptably high rates. (13) The Department added citations to the *Calfarm* and *20th Century* cases, CIC section 790.02 and the *Erreca* case to clarify its rulemaking authority, the reference statutes being implemented, and how the regulation is an effort to make the nature of the offset consistent with the nature of disability income insurance coverage as defined in the *Erreca* decision. The Department also added a citation to *Canova v. N.L.R.B.* (9th Cir. 1983) 708 F.2d 1498 in response to this comment. The authority cited by the Department supports the regulation and is contrary to the assertion that permanent workers' compensation benefits "cover the same risk" as long term disability policies. The court in *Canova v. N.L.R.B.* (9th Cir. 1983) 708 F.2d 1498 held that an award "which is reparation for permanent physical injury…is not compensation for lost wages during a particular period and is not deductible" from a backpay award. *Canova v. N.L.R.B.,* 708 F.2d 1498 at 1504. The *Canova* court cited and quoted the

Commenter	Synopsis or Verbatim Text of Comments	Response
	detail for these advertisements and this is problematic. Invitations to contract, which are advertisements that are neither an invitation to inquire nor an institutional advertisement are more detailed advertisements in terms of coverage. And while we don't disagree with describing offsets in that category, the detail required by the regulation is too broad and burdensome. Some group policy owners may design their plans so they don't permit certain offsets, and the regulation would require being specific to particular groups in a general advertisement.] Not being clear in the scope and applicability, the regulation creates significant financial and administrative burdens because it applies to all group disability advertising, including invitations to inquire and institutional advertisements. The application of this proposed rule should be narrowed The Department should consider adding language to the proposed regulation excluding institutional advertisement as defined in Section 2535.3(g) and an invitation to inquire as defined in Section 2535.3(h). If the Department does not change the language of the proposed regulation, then it should restrict application of the proposed regulation to invitations to contract in the same fashion as set out in existing Guideline 2536.2(b)(1). That Guideline states that: (1) an institutional advertisement as defined in Section 2535.3(g) is not subject to the proposed regulation, and (2) an invitation to inquire as defined in Section 2535.3(h), which mentions either the dollar amount of the benefit payable (including when expressed as a percentage of wage or earnings) and/or the period of time during which the benefit is payable, must include a description of each such reduction and the circumstances under which the reduction would apply, including an illustrative example, and appearing with the same prominence as the maximum benefit amount. The proposed regulation should exclude group disability income insurance issued to employer groups. One of the stated public	*Russell* case in support of its holding: "'temporary disability payments are a substitute for lost wages during the temporary disability period, while permanent disability is for permanent bodily impairment and is designed to indemnify for the insured employee's impairment of future earning capacity or 'diminished ability to compete in the open labor market.'' 120 Cal. Rptr. at 634 (citations omitted)." *Canova v. N.L.R.B.* (9th Cir. 1983) 708 F.2d 1498, 1504, citing *Russell v. Bankers Life Co.,* 46 Cal. App.3d 405 at 416. Because disability income insurance policies are designed to provide a substitute for earnings when, because of injury or disease, the insured is deprived of his capacity to earn a living, "[A] reasonable person would not anticipate that permanent disability benefits under the Workmen's Compensation Act will be deducted from the amount of payment under the disability policy." *Russell v. Bankers Life Co.* (1975) 46 Cal. App.3d 405, 416-417. The Department believes the regulation is supported by these authorities and believes the commentator's position misconstrues *Russell*, the Labor Code, and related law. The Department agrees that it is good public policy to permit integration of disability benefits to prevent claimants from receiving double recoveries. The regulation prohibits policy provisions which go beyond this and allow offsets for workers' compensation permanent disability benefits because such provisions would be inconsistent with the law cited as reference authority for the regulation and would therefore be misleading. (14) No change. The Department has responded to this lack of authority comment above in connection with other

Commenter	Synopsis or Verbatim Text of Comments	Response
	policy reasons for the change is that the Department sees that "*problems arise when the purchasers of such policies or the persons insured by such policies are unaware at the time the policy is purchased that the insured will not receive the maximum benefit amount stated in the policy marketing material*." We have not seen evidence in the marketplace that employers are unaware of the offsets in the group disability policies. In fact, it appears that employer groups - the vast majority of which are governed by the ERISA - have designed their employee benefits program with offsets as an essential feature. Employers and their insurance agents are sophisticated purchasers who choose to design their plans with certain offsets. Thus, we would request that advertisements directed only at employer policyholders should be exempted. Page 7 of 7 We do believe it is possible to craft a clear discloser that would be helpful to the consumer. For example, we believe it would be clear to state that: "The LTD policy pays a benefit of 60% of pre-disability earnings, to a maximum of $10,000 per month, reduced by Social Security disability or retirement benefits, workers' compensation disability benefits, and other specified offsets." We would be happy to discuss this issue further with the Department. Thank you for your consideration of these comments. Please feel free to contact us with any questions. (18) [T 11: The Department has no authority to adopt regulations to implement the Labor Code.] (19) [T 25-26: In terms of the overview and cost impact of the regulation on business in California, Mr. Mangan of ACLHIC stated that there is a significant cost impact on private and public businesses in California which are the group policyholders purchasing group disability income insurance coverage.	sections of the regulations. (15) No change. In most settlements via Compromise and Release the temporary disability indemnity has already been paid, and the settlement is primarily, if not totally, for permanent disability, future medical treatment, and the other benefits to the carrier of completely closing a case. Therefore, the disability income insurance carrier's ability to impose offsets is limited if existent at all. However, even if temporary disability indemnity is an issue, as it can be in a denied case, settlements include provisions for future medical treatment and other issues including death benefits, the right to re-open, vocational rehabilitation, penalties, outstanding medical expenses, and a panoply of other possible issues. So in any Compromise and Release there could be a dispute as to what amount is available for offset, regardless of whether the offset claim is limited to temporary disability indemnity or whether it could include permanent disability indemnity as well. There is no reason to believe that this regulation would lead to any additional litigation or disputes. There is also no reason to believe this regulation would lead to any more delays, as one would expect the disability income insurer to file a lien in any case where they paid benefits and this lien would have to be resolved however the case is settled and regardless of whether the lien could include permanent disability or not. (16) The Department added citations to the *Calfarm* and *20th Century* cases and a reference cite to CIC 790.02 to clarify its rulemaking authority and reference statutes

Commenter	Synopsis or Verbatim Text of Comments	Response
	Integrating benefits and over-insurance are most important in a group insurance context, and that's a context where an employer is the client, and can be anything from a small business to a large corporation, to a school district, state or county government, virtually any kind of public group as well, and they want this type of benefit for their employees and they will need to react to the cost implications of allowing or not allowing offsets. They will also have to react to a script of materials and other internal communications as a result of this rule and that will have a cost impact on them.] (20) [T 26-27: Mr. Frank stated that many protections are in the Settlement Agreement that the industry had with the Insurance Commissioner. The Settlement Agreement is consistent with industry practice and we have no quarrel. We don't estimate and deduct workers' comp that is being disputed and pending. So we can work out adequate protections that are consistent with our practice that will satisfy the Department. But it is contrary to public policy to have a flat-out ban in deducting these kinds of benefits and it will negatively impact the availability of group disability insurance in California, or its affordability.]	being implemented. The necessity for the regulation is evidenced by comments made by Cassie Springer-Sullivan, an attorney who has worked with these issues for the past five years. Her comments indicate that there are many instances in which insurers overestimate and then deduct estimated earnings from the benefits that they pay their insureds. [Rulemaking file, Volume 1, Tab O, hearing testimony, pages 30:8-31:18] A regulation which sets forth that these estimates are subject to a standard of good faith is consistent with California law. The cited authority supports the regulation. Policy provisions which allow such estimates but which are not interpreted in accordance with a duty of good faith are misleading. The Department believes that the regulation is a simpler way of interpreting CIC 790.03's requirements than seeking legislation. (17) The Department has changed the regulation in response to a portion of these comments. The Department added cites to the *Calfarm* and *20th Century* cases and a reference cite to CIC 790.02 to clarify its rulemaking authority and the reference statutes being implemented. The necessity for this regulation is evidenced not only by the public comments in the record that say the public is not adequately informed of offsets, but also by the insurers' marketing materials themselves. [Rulemaking record, Volume 2, Tab E] These materials do not adequately explain to the public the extent to which various offsets reduce the benefit that is actually received by the insured. Some materials do not even mention

Commenter	Synopsis or Verbatim Text of Comments	Response
		offsets at all, yet policy forms contain several offsets that operate to reduce the benefits an insured could receive. Inclusion of an example of how offsets reduce benefits, as shown in the marketing materials of The Standard Insurance Company, is certainly feasible, and not overly burdensome. That is the sort of disclosure the regulations would require. The fact that the insurers will incur some expense in revising their materials does not outweigh the detriment to the public of not understanding the coverage provided. Hartford notes that these products are not understood by the public in its marketing study titled "Unintended Exposure: The surprising 'Big Gamble' Employees Take Every Day," page 8, "Why should employees buy coverage when they don't even understand what it does?" [Rulemaking Record, Volume 2, Tab E] The Department believes that the regulation is necessary in order for the public to better understand the potentially huge impact that offsets can have on benefits actually received. It is irrelevant whether an employer or employee pays for the coverage – both are entitled to better disclosure. It is also irrelevant whether employers choose to create their own descriptive materials. Insurers' materials must disclose material information as well, and better disclosure by insurers can only further better disclosure by employers. The assertion that marketing materials must be "clear and brief" does not justify more limited disclosure. However, the Department has made changes to the regulation in response to portions of this comment. The

Commenter	Synopsis or Verbatim Text of Comments	Response
		Department agrees that the original scope of the regulation was overbroad. For one thing, it required insurers to "describe each such reduction" and contain an example of how the reductions would apply. Given that one policy may have many offset provisions, and not all offsets will apply to each insured, the Department agrees with the commentator that this requirement is too broad. In addition, the commentator observed that the scope of the regulation was too broad, encompassing all kinds of advertising, including items such as one-page flyers. The Department agrees with this observation as well. Therefore, the Department amended the regulation to simply require that invitations to contract, as opposed to all advertisements, contain an example of how at least two common reductions, or offsets, would reduce the dollar amount of the maximum benefit an insured would receive. The regulation also now states that the insurer may couple the example with a disclaimer which explains that the example is for illustrative purposes, and is not intended to reflect the situation of a particular claimant under the policy. The Department declines to exclude group disability income insurance issued to employer groups from the scope of the regulation. The Department believes the insurers' marketing materials, which include materials for both employers and employees, do not adequately explain the effect of offsets to either. Moreover, most of the group disability income insurance policies sold in California are sold to employer groups. The commentator's suggested amendment would ensure that the bulk of disability income insurance coverage sold in California would not be subject to the higher standard of

Commenter	Synopsis or Verbatim Text of Comments	Response
		disclosure required by the regulation. It would also create a two-tier system of disclosure: one for employer groups, and one for other groups. The Department declines to limit the regulation in this way. Finally, the suggested disclosure at the end of these comments is the kind of disclosure that already exists in some companies' marketing materials. The Department does not regard it as adequate notice of the impact that offsets may have on benefits paid. (18) No change. The Department is not adopting regulations to enforce the Labor Code. The Department is adopting regulations to interpret and enforce the Insurance Code in a manner that is consistent with California law, including provisions of the California Labor Code. (19) The Department accepts that the regulations may have some impact on the cost of policies and costs to policyholders if insurers choose to raise their rates for the coverage provided. However, if the current cost of coverage is based upon offsetting benefits that may not be offset under the regulations, any increased cost, and related costs to policyholders, would be incurred because the coverage is being brought into conformity with the legal authorities cited in support of the regulations. Moreover, it is unclear whether a premium increase would increase the cost of coverage because the regulations require that better coverage be provided. (20) The Settlement Agreement and the Amendment thereto are included in the rulemaking file under Tab E of Volume 2. The Department is required to adopt

Commenter	Synopsis or Verbatim Text of Comments	Response
		regulations on the topics set forth in paragraph 25 of the Agreement no later than May 19, 2008, and the Department has done so with this rulemaking proceeding.
Cassie Springer-Sullivan, plaintiff's attorney with Lewis, Feinberg, Lee, Renaker, & Jackson. Verbatim text of hearing testimony on 7/10/07.	[T: Thank you. I'm Cassie C-a-s-s-i-e, last name is hyphenated, it's Springer-Sullivan, S-p-r-i-n-g-e-r, hyphen, S-u-l-l-i-v-a-n. I'm a plaintiff's attorney with Lewis, L-e-w-i-s, Feinberg, F-e-i-n-b-e-r-g, Lee. L-e-e, Renaker, R-e-n-a-k-e-r, and Jackson. I've listened to the comments this morning and thought I would add a plaintiff's perspective in response to some of the comments, a planned participant perspective. (1) First, I just want to say that I think these regulations are necessary and are helpful to participants to enable them to understand what their benefits are from the get-go, from when they sign up for the insurance policy, or when their employer signs up for the policy, so they can figure out if they need more insurance, because this policy may not cover them and provide them with as much as a benefit as they would have anticipated. (2) There was a comment that there's not been a showing of necessity for some of these regulations, and I have been representing participants in these plans for about five years, and I think the necessity, from my perspective, is profound, particularly in three categories: the permanent disability offset, the workers offset, and the surprise when the advertisement for the disability benefits is not actually what they receive. (3) With respect to the permanent disability offset, it is my experience that 100 percent of the time permanent disability is requested as an offset by the insurance company, and in fact is taken as an offset regardless of a	(1) No change. There is no need to amend the proposed regulations to accommodate this comment. (2) No change. There is no need to amend the proposed regulations to accommodate this comment. (3) No change. There is no need to amend the proposed regulations to accommodate this comment. (4) No change. There is no need to amend the proposed regulations to accommodate this comment. (5) No change. To the extent the comments may be a request that the Department require insurers to base offsets for earnings on what someone as earned as reported on their tax return, this would be more restrictive on insurers than the proposed regulation in that it would allow only one method for the offsets. The Department declines to limit insurers to just one particular method of supporting offsets based on amounts earned by the insured. The Department's proposed regulation, which requires insurers to act in good faith in estimating offsets for earnings for work performed while disabled, should, if followed by insurers, be as effective in carrying out the purpose of the regulation. (6) No change. There is no need to amend the proposed regulations to accommodate this comment. (7) No change. There is no need to amend the proposed regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
	protest of a planned participant, despite what the plan terms say. Permanent disability, as you know, is awarded for the fact that there is a disability; it's not income replacement. In other words, under the workers' comp system, someone can have lost an arm and can still perform their work duties without any problems, so they don't have any kind of earnings reduction. But they still are awarded permanent disability for the fact that they have suffered a loss of that arm. So it doesn't affect the earnings. And yet, most disability policies take that as an offset against something that's designed to protect against their loss of earnings; in other words, their long-term disability plan. So it's just universally my experience that that has happened. I have filed lawsuits to try to get insurance companies to change their mind, and insurance companies have not. I think it's necessary, and it ensures that the benefits provided by long-term disability plans are not reduced by any- and everything. It's only reductions for like benefits; in other words, for benefits that replace lost earnings, which permanent disability benefits do not. (4) On the estimated work earnings regulation, I also think this is necessary and very smart. My experience also is that I don't actually have a single client who doesn't want to try to get back to work. Nobody wants to be disabled, and they all at some point, in my experience, if they're able, they try. And so maybe they will enter in the workforce temporarily, and then they get a reinjury and they can't. They have to return back to being on disability status. Or maybe they are able to do something that's only	

Commenter	Synopsis or Verbatim Text of Comments	Response
	sporadic, such as, I had a client who was able to try to sell houses every once in a while, when she was feeling okay. But it was very sporadic. It was only when her injury wasn't profound that she was able to go out and market a house. In every instance where I have had a client do this, the insurance company insists on taking the one paycheck that they're able to get and using that as an estimated offset against their long-term disability benefits for the rest of the year, despite the fact that the client may not actually be able to sustain that kind of income over the course of the year, because of the disability. (5) I think the estimating is problematic, and it makes so much more sense, and it is actually so much easier, to simply take an offset based on what somebody earned, as reported on their tax returns. In other words, the year after somebody has these earnings, when they file their tax returns, they could submit those to the insurance company, and the insurance company says, "Okay, you had X amount in work earnings, so you owe us that amount for last year." And whether they deduct that against their benefits going forward or in a lump sum, the insurance company is able to recoup the benefit without having to estimate for something that may be a phantom income. (6) Finally, I wanted to comment on the advertisement regulations, which I believe are great, really. I can't tell you the number of times where a client has been completely surprised, that they thought they had a long-term disability benefit that would provide them with 60 percent of their earnings, and they had no idea it was going to be reduced to a minimum benefit of $50, or even zero, because of other income that they have received from other	

Commenter	Synopsis or Verbatim Text of Comments	Response
	sources. It's also my experience that we have declined to take many cases because the offset is so severe that it's not worth the insured to pay an attorney to fight the denial of their disability benefits for a benefit that comes out to $100 or $150 a month, maybe, after all of the offsets are taken. But the insured has no idea that their LTD benefit was essentially nonexistent, because they didn't have the plan, maybe they were too sick to understand the plan, and it was never advertised, from the beginning. So I think it's very smart for advertisements to adequately represent that you're not getting 60 percent of your pre-disability income. What you're getting is a percentage of your income reduced by several different sources, and to specify, by your retirement, by your workers' comp, by your social security. I don't think this is going to become a doomsday scenario, as was indicated, of 45 different examples. I think the way that CDI spelled it out, the regulation is very clear, very straightforward, and very easy. (7) The one problem I think insurance companies have with it is that it's going to make people think before buying policies. Thank you very much.]	
John Metz, chairman and executive director of Just Health, a nonprofit public benefit corporation.	Summary of written comments filed on 7/10/07: (1) Pages 1- 3: At a pre-notice public discussion on 10/30/06 about the proposed "Offset" regulations, CDI General Counsel Gary Cohen stated that based on the information then in the Department's possession relating to the application "offset" provisions, the Department was	(1) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (2) No change. This comment and the attached exhibits,

Commenter	Synopsis or Verbatim Text of Comments	Response
Text of written comments filed on 7/10/07 is summarized with synopsis of additional written comments and 7/10/07 hearing testimony added where comments and testimony is in addition to and not duplicative of written comments filed on 7/10/07.	unable to determine whether these policies provided any economic benefit - Mr. Metz had the same problem. Mr. Metz cites an article published on a California Healthline website concerning how many millions of Californians have disability income insurance coverage. (2) Pages 3-8: On October 30, 2006 the Dept. asked the industry representatives to provide more information about the economic benefit of these policies. The Department sent a letter to the industry's trade group dated November 29, 2006 to get more information about the economic benefit of the policies and the industry's trade group responded by letter dated February 28, 2007. Mr. Metz criticizes the trade group's response. The letters are attached as Exhibits A and B. (3) Page 6: The practices which are barred by the substance of the Department's regulations (sections 2232.45.2, 2232.45.3, 2232.45.4, and 2232.45.5) "violates, or is prone to violate, existing law." (4) Page 9: If the Department doesn't have this information, and agents and brokers don't have this information or don't disclose it, how can consumers determine whether the policy has any economic benefit? (5) Pages 9-16: Mr. Metz discusses the market conduct/claims handling problems of UNUMProvident insurers, "the nation's largest disability insurer," the Department's and other states' enforcement actions against UNUMProvident companies, the resulting settlement agreements, and UNUMProvident companies' claims handling practices. Unless all of this information is	which were drafted before the regulations existed, do not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (3) No change. There is no need to amend the proposed regulations to accommodate this comment. (4) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (5) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (6) No change. This comment seeks to expand the scope of the regulations into a new area: the disclosure responsibilities of agents and brokers. The Department declines the commentator's invitation to expand the scope of the regulations into this new subject area. There is no need to amend the regulations to accommodate this comment. (7) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. This comment seeks to expand the scope of the regulations into a new area: the disclosure responsibilities of agents and brokers. The Department declines the commentator's invitation to expand the scope of the regulations into this new subject area. There is no need to

Commenter	Synopsis or Verbatim Text of Comments	Response
	disclosed to the consumer, consumers can't make a rational informed decision about buying the coverage, and the true meaning of the offset provisions is unintelligible, ambiguous, abstruse, or likely to mislead. (6) Pages 16-17: Because agents, brokers, and consultants earn their fees from insurers, without regard for what is best for the customer, the regulations must contain provisions mandating that any licensee who advertises, markets, or sells group disability insurance policies fully disclose the effect of each offset. (7) Pages 17-19: Mr. Metz gives examples as to why consumers need better disclosure of the effect of offsets. He cites CIC sections 330, 332, 334, 360, and 790.03(a) as support for requiring more disclosure. (8) Page 19: Insurers require disclosure of material facts from consumers. Consumers are entitled to disclosure of material facts from insurers. (9) Pages 20-21: Adequate disclosure of offsets is important at all stages of the insurer-insured relationship, from advertising a policy to events following the handling of a claim. Consumers are likely to be misled without full disclosure of the effect of offsets. If the true effect of offsets were fully disclosed to consumers, the consumer might either not buy the coverage or pay substantially less for it. (10) Pages 21-22: Mr. Metz discusses a treatise by Richard E. Stewart and Barbara D. Stewart titled, "The Loss of the Certainty Effect," a copy of which is attached	amend the proposed regulations to accommodate this comment. (8) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (9) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (10) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (11) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (12) The Department amended the regulations to include a citation to CIC 790.02 in response to this comment. The regulations already reference CIC section 790.03. The Department declines to expand the scope of the regulations to include the other statutes and regulations cited. (13) No change. The Department is not enforcing the Business and Professions Code nor the Civil Code. It is enforcing the Insurance Code. The comment seeks to

Commenter	Synopsis or Verbatim Text of Comments	Response
	to his written comments as Exhibit C. This treatise explains how the certainty of claims payment is the central factor in determining whether an insurer can sell its product and for how much. Mr. Metz also cites an article by Arnold J. Rostoff, professor at University of Pennsylvania, concerning how consumers are unhappy with insurance coverage. These articles support fuller disclosure of offset provisions. (11) Pages 23-24: People buy disability income coverage to protect themselves, and they discover at their weakest moment, when they are disabled, that they have been betrayed or cheated by misleading or undisclosed offsets in their policies. (12) Pages 24-26: Undisclosed, inadequately disclosed, or illegal offsets violate CIC sections 330, 332, 790.02, 790.03(a), 790.03(b), 790.03(h), and CCR section 2695.1 et seq. Group disability policies must be approved by the Department for sale in California. CIC section 42; 10 CCR section 2695.2(j). (13) Pages 26-27: It is urged that offset provisions violate Business and Professions Code sections 17200 et seq. and 17500 et seq. and Civil Code sections 1770(a)(5),(7),(9),(14),(16),(17) and/or (19), and that these sections provide adequate grounds for the Commissioner's regulations and for the withdrawal of approval of policies containing undisclosed, inadequately disclosed, or illegal offsets. (14) Pages 27-28: The proposed regulations must ensure that unlawful offsets are eliminated and prohibited; that	expand the regulations into a new subject area. The Department declines to expand the scope of the regulations to include the statutes and regulations cited. (14) No change. The comments generally support the regulations. The comments do not request any specific changes to be made to the regulations. To the extent they may be read to do so, the changes would expand the regulations into a new subject area, which the Department declines to do. There is no need to amend the proposed regulations to accommodate this comment. (15) No change. Insurance Code section 10291.5 concerns the review and approval of insurance policy forms, which is outside the scope of the regulations. Insurance Code sections 12921 and 12926 do not create mandatory duties on the part of the Commissioner and they do not grant rulemaking authority. The Department declines to expand the regulations into a new subject area. There is no need to amend the proposed regulations to accommodate this comment. (16) The Department added a reference citation to 790.02 to the regulations in response to this comment. Except for this, there is no change. The Department agrees that the Commissioner has authority to adopt the regulations. However, the comment fails to distinguish between "regulatory authority" and rulemaking authority, the latter of which pertains to the regulations. Insurance Code sections 330, 332, 780, and 781 come from a different article of the Insurance Code than the one the Department is implementing with rulemaking under CIC section 790.10. For this reason, and because these sections

Commenter	Synopsis or Verbatim Text of Comments	Response
	there is full disclosure of all material information to consumer, enabling them to make an informed decision regarding which policy, if any, to buy; and that the Commissioner fulfills his statutorily mandated duty to enforce the Insurance Code. The regulations will go a long way towards preventing undisclosed, inadequately disclosed, or illegal offsets. It will allow the "magic of the marketplace" to provide the best value for consumers. (15) Pages 28-29: It is the Commissioner's right and duty to solve the problems addressed by the regulations. The CIC provides that the conduct which the proposed regulations address shall not be permitted in California. E.g., CIC 10291.5(a)(1)and (2); CIC 10291.5(b)(1) and (7)(A), and (13). CIC 12921(a) and 12926 provide that the Commissioner "shall" perform his duties, "shall" enforce the law, and "shall" require full compliance from insurers with all provisions if the Insurance Code. (16) Page 30: The Commissioner has authority to adopt the proposed regulations (case citations omitted in this summary). The Commissioner's regulatory authority over disability income insurance derives from Insurance Code sections 790.10, 330, 332, 780, 781, 790, 790.01, 790.02, 790.03, 790.036, 12921, and 12926. (17) Page 31: The commentator files Exhibit D, a tracked, edited version of a portion of the Department's Notice of Proposed Action with suggested changes regarding the effect the regulations will have on businesses, the ability of California businesses to compete, and the potential cost impact on consumers and businesses. Exhibit D states that the regulations will have a significant statewide positive	introduce new material that expands the scope of the regulations into new areas, the Department declines to amend the regulations to include these sections. The Department believes that the citations to sections 790 and 790.01 are unnecessary and surplusage, and the Department declines to include them. CIC sections 12921 and 12926 do not grant rulemaking authority. To the extent the citations listed go beyond what the Department has already cited in support of the regulations, the Department declines to amend the regulations to include this new material and thereby expand the scope of the regulations. There is no need to amend the regulations further to accommodate this comment. (17) No change. The commentator's comments support the necessity for the regulations, albeit with some level of speculation, but they do not address the language of the regulations or the rulemaking procedure followed. There is no need to amend the proposed regulations to accommodate these comments. (18) The Department added a reference citation to 790.02 to the regulations in response to this comment, and substituted "certificate holder" for "insured" in section 2232.45.5. The Department made no other changes in response to these comments. The citations to CIC sections 780 and 781 come from a different article of the Insurance Code than the one the Department is implementing with rulemaking under CIC section 790.10. For this reason, and because these sections introduce new material that expands the scope of the regulations into new areas, the Department declines to

Commenter	Synopsis or Verbatim Text of Comments	Response
	economic impact on all businesses which buy disability income insurance. The regulations prohibit unlawful benefit reductions and require better disclosure, so businesses will be able to make better choices about purchasing coverage, and insured employees will better understand their coverage. Businesses with better coverage will be able to obtain and retain the best employees. Insurers who do not engage in unlawful practices will no longer be competitively disadvantaged. Consumers in other states are affected in the same negative way as California consumers. Insurers that do not engage in the practices identified in the regulations will be offering better products and will be able to better compete. The regulations will have a significant positive statewide impact on purchasers of disability income policies, including small businesses. Purchasers will be able to make more informed decisions, will understand coverage better, and employees will be able to decide where to work based on better information. Employers will have better relations with employees. The real cost of disability will not be squandered on illusory promises. Insurers who follow the regulations will be saved costs when they compete with those who don't. The cost impact on insurers is unknown. They may have to change policy forms and advertisements. The regulations should have no cost impact because insurers should not be making these kinds of benefit reductions anyway. (18) Page 31: The commentator files Exhibit E, a tracked, edited version of the regulations with proposed changes.	amend the regulations to include these sections. The Department declines to expand the scope of the regulations to include new subject matter under CIC 790.036, which pertains to advertising of insurance that will not be sold. As stated above, CIC sections 12921 and 12926 do not grant rulemaking authority. The *Eddy v. Sharp* decision concerns agent liability, a topic beyond the scope of the regulations. It does not address the proposed regulations or the rulemaking procedure followed. There is no need to amend the proposed regulations to accommodate that citation. Existing law sets forth a "good faith reasonable basis" standard. The Department declines to abandon this in section 2232.45.5 in favor of limiting good faith to the commentator's narrower, somewhat uncertain, fact-based criteria. The Department declines to expand the scope of the regulations to include the entirely new section 2232.45.6 proposed by the commentator. It also appears unnecessary for achieving the purpose of the regulation to include three examples of offset combinations in the regulation. The Department has rejected a requirement that insurers demonstrate each type of offset as being impractical and too burdensome. The amendment to section 2535.3 regarding economic value is a vague standard which would expand the scope of the regulations proposed. The Department declines to adopt it. The Department believes deletion of the word

Commenter	Synopsis or Verbatim Text of Comments	Response
	The changes add CIC sections 780, 781, 790.02, 790.036, 12921, and 12926, and the *Eddy v. Sharp* (1988) 199 Cal. App.3d 858, 865-866 case as a reference citations. The comments change the reference to "insured" in section 2232.45.5 to "certificate holder," and they delete the "good faith reasonable basis" standard and substitute a more restrictive fact-specific list of requirements that the insurer must prove in order to comply with the regulation. The comments add an entirely new regulation, section 2232.45.6, which requires any licensee to meet strict disclosure requirements concerning offsets, both in the sale of products and in advertising. The new section sets forth three examples of offsets, and requires that licensees use examples that include reductions for each type of offset that may be applied. The Commentator cites *Gruenberg v. Aetna Insurance Co.* (1973) 9 Cal.3d 566 as reference for the new regulation, in addition to other authorities cited above. The comments suggest amendments to an existing regulation, section 2535.3, that announcements must disclose whether the contract or program "provides any economic value to the certificate holder." It is unclear whether the comments propose deleting the word "hospitalization" from existing Guideline 2536.2(a)(4). Finally, the comment amends section 2536.2(b)(4) to set forth three particular examples of offsets, and to require that the actual examples used must include reductions for	"hospitalization" in existing section 2536.2(a)(4) is an error. Regardless, it is irrelevant to the proposed regulations. Finally, as noted above, the Department finds it unnecessary for section 2536.2(b)(4) to set forth three examples of offsets. The requirement that each type of offset be specified is impractical and too burdensome. Therefore, the Department declines to implement these proposed changes. ____ Responses to additional written comments included after page 31 of the commentator's last filed written comments: (1) No change. The commentator's comments regarding property insurance are irrelevant to the proposed regulations and the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate these comments. (2) No change. The commentator's comments concerning market conduct allegations in litigation involving UNUMProvident Corp. and other insurance companies do not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
	each type of offset that may be applied. ____ Additional written comments included after page 31 of the commentator's last filed written comments(synopsis): (1) The commentator includes several pages of comments which concern property insurance. (2 The commentator includes comments regarding market conduct allegations made in litigation concerning the market conduct of UNUMProvident Corp. and other insurance companies. (3) The commentator discusses sections of the Insurance Code in connection with the regulation of property insurance. ____ Additional comments made at the July 10, 2007 hearing that do not duplicate the written comments (synopsis): (1) The insurance industry is built on trust, and if there is no trust the product itself is highly suspect. (2 If disability income insurance has real value, the marketplace will pay a fair price for it. If it has no real value, it is a blight on the entire economy. (3) A Vice President of Metropolitan Life said in the July 2, 2007 California Health Line article that long term disability generally provides between 60 and 80 percent of	(3) No change. The commentator's comments are irrelevant to the proposed regulations and the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate these comments. ____ Responses to additional comments made at the July 10, 2007 hearing that do not duplicate the written comments: (1) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (2) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (3) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. However, this comment does illustrate necessity for better disclosure of offsets. (4) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
	a disabled person's salary from two to five years, until a person retires. Yet the February 28, 2007 letter from ACLHIC says "It is not intended that disabled employees receive an aggregate replacement income from public disability, workers' compensation, sick pay, retirement benefits, private disability insurance, and other sources in excess of the amount of income that they received prior to their disability." I've never seen an ad that says, "You are going to get 60 to 80 percent of your benefits…but in reality you're going to get 50 percent or 10 percent, or nothing." (4) Insurance companies have the information to establish the real economic value of these policies, and this information is material. (5) Insurance Code sections 334, 360, 330 and 332 pertain to materiality and disclosure obligations. (6) Mr. Metz discusses four categories of relationships between insurers and members of the public affected by disability income insurance coverage. He provides examples of why these groups of people need better disclosure of offsets and how insurers implement offsets. There is no rational basis for not compelling the industry to tell people what they are selling before people choose to buy it. (7) Brokers, agents, and consultants do not know enough about the economic value of these policies to adequately explain the policies to the public. They have a fiduciary duty to disclose information. And because they receive compensation from the industry they are in a conflicted	(5) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (6) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (7) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (8) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. However, this comment does illustrate necessity for better disclosure of offsets. (9) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (10) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (11) No change. This comment does not address the

Commenter	Synopsis or Verbatim Text of Comments	Response
	position. [The commentator then proposes regulation language summarized and responded to above.] (8) If an offer of coverage is false or inadequate, the time and money businesses spend evaluating it is wasted, and if they purchase the coverage the harm is compounded. So it is important that advertising be full, accurate, and complete. (9) The industry objections that it is to hard, too complex, and too much writing to explain the product is nonsense. The industry is selling a product and the only way a buyer can make an informed decision is to know what the product provides in exchange for what they're paying for it. (10) The Department doesn't have the right to approve any policy of that kind, and the Commissioner has the authority to withdraw approval of a policy. (11) Any negative the regulations may have on insurers' marketing and sales is not an excuse for breaking the law. (12) I have no problem with insurers earning as much money as they are able, provided people make an informed decision about what they are buying. (13) The insurers' remarks about public policy, integrated benefits, overinsurance being a problem, employers' reaction to cost implications, and various statements of industry practices are not supported by verified facts in the Department's possession, so absent supporting evidence these positions should not be considered.	proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (12) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (13) No change. This comment does not address the proposed regulations or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment. (14) No change. There is no need to amend the proposed regulations to accommodate this comment. (15) No change. There is no need to amend the proposed regulations to accommodate this comment. (16) No change. The Department declines to expand the scope of the regulations to encompass the amendments suggested.

Commenter	Synopsis or Verbatim Text of Comments	Response
	(14) With regard to sections 2232.45.2 and 2232.45.3, there is no evidence that if insurers are allowed to estimate, that these estimates will produce a result that would have been understood by the four categories of people affected by these policies at the time coverage was sold. Based on the industry's record, e.g., UNUM, there is no rational basis for trust. Insurers should not be left with discretion to estimate anything, but rather should be allowed to recapture what the law permits them to recapture when it is actually paid to the claimant. (15) The presumption should be that offset provisions are ambiguous, uncertain, and misleading. I assume the law supports the regulation's position on offsetting permanent workers' compensation disability benefits, but if the law is otherwise, I have no problem with eliminating these benefits as a prohibited category. (16) There was an article quoting Brad Wenger of ACLHIC which concerned a dispute between insurers and brokers and agents over who had how much responsibility for disclosure. It is essential that agents and brokers be covered by the regulations.	
Matt Monaghan, attorney for UNUM insurance companies. Synopsis of testimony at	Mr. Monaghan responds to Mr. Metz' criticisms of UNUM by inviting him to discuss UNUM's claims-handling practices and procedures and related matters. Mr. Monaghan has made himself available to every Dept. of Insurance in the country and UNUM is being as open about its improved claims-handling as possible. UNUM is doing its best to improve its reputation and move forward.	No change. This comment does not address the proposed regulations themselves or the rulemaking procedures followed. There is no need to amend the proposed regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
hearing on 7/10/07.	UNUM has numbers on coverage and claims. UNUM can look at someone's policy and calculate the present value of the benefits that person would be entitled to in every case. UNUM pays out $6 million a year in benefits, and people who have coverage are in a better position than those who don't.	
	COMMENTS ON THE APRIL 8, 2008 VERSION OF THE PROPOSED REGULATIONS	
Ron Dean, attorney: Verbatim text of e-mail dated 4/11/08.	I'm writing to comment on the Proposed Regulation noted above. (1) I wanted to compliment you and the Department on the excellent job you've done in identifying so many of the ways in which consumers are not being properly informed about insurance purchases. You've taken the time to catalog the great majority of them, have engaged in critical thinking about the core of your objections, and carefully drafted statements to communicate and deal with those objections. I just had a few questions: 1. (2) With regard to §2232.45.2, and "voluntary retirements," a situation I often see in my practice is where disability benefits are denied and during the often long process of obtaining those benefits, the client needs the money on which to live and is forced to take an early retirement. The insurance company later pays the disputed benefit but claims, as a set off, the monies from the retirement their own wrongful denial forced the client to take. I've not seen any court willing to provide a remedy in such situations.	(1) No change. There is no need to amend the proposed regulations to accommodate this comment. (2) No change. This comment does not address the changes made in the 15-day notice. The commentator does not suggest a particular change to proposed section 2232.45.2 which would remedy the problem. The Department has considered this comment but declines to expand the scope of the proposed regulation to create a new standard that addresses this issue. (3) No change. This comment does not address the changes made in the 15-day notice. The effective date will be determined according to the requirements of California Government Code section 11343.4, which states that a regulation required to be filed with the Secretary of State shall become effective on the 30th day after the date of filing unless subsections (a), (b), or (c) of that section apply to dictate another effective date. In view of the applicability of Government Code section 11343.4, the Department declines to expand the scope of the proposed regulations to include an effective date provision. (4) No change. This comment does not address the changes made in the 15-day notice. Whether or not there is a private cause of action or private enforcement mechanism is a matter for the courts to determine. The

Commenter	Synopsis or Verbatim Text of Comments	Response
	2. (3) I don't see an "effective date" for the substantive regulations. I understand there is a difficult problem regarding when a policy "expires" so that new regulations can take effect. It seems to me that a policy expires when the period for which a premium previously paid is used up. Otherwise, policy forms, and even previously issued policies, can last for generations, effectively negating much of the Commissioner's power to improve consumer protection. In any event, I don't see an effective date, or a definition of that effective date, with respect to the substantive (non-advertising) provisions. I assume the advertising provisions would become effective immediately. 3. (4) Enforcement. It would be difficult and expensive for the Department to patrol all the policies issued by all insurance companies to assure compliance, but I don't see any provision for private enforcement in these regulations. (5) Again, the Department has done a terrific job in addressing some very serious problems in the industry and I am optimistic that we will be seeing dramatic improvement in the quality of information flow to consumers.	proposed regulations do not create or bar a private cause of action or private enforcement mechanism. (5) No change. There is no need to amend the proposed regulations to accommodate this comment.
James P. Keenley, attorney with Lewis, Feinberg, Lee, Renaker, & Jackson:	Thank you for the opportunity to comment on the Insurance Commissioner's proposed revisions to the California Code of Regulations. Lewis, Feinberg, Lee, Renaker & Jackson, P.C. is a national law practice that represents plaintiffs in employment litigation, including litigation	(1) No change. There is no need to amend the regulations to accommodate this comment. (2) No change. There is no need to amend the regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
Verbatim text of letter dated 4/23/08.	under the Employee Retirement Income Security Act of 1974,29 U.S.C. 1001 *et.* seq. ("ERISA"). Over the past 25 years the firm's work on behalf of employees has resulted in several landmark cases that changed the employee benefit and employment practices of major companies, restored lost benefits and wages to hundreds of thousands of employees, and established important legal precedents on behalf of employees, disabled employees, and retirees. (1) We write to express our strong support for the Commissioner's proposed regulations prohibiting benefit reductions based on involuntary retirement and worker's compensation payments. These regulations are consistent with existing law, and further the policies expressed in the California Insurance Code and ERISA by ensuring that disability insurance and retirement benefits are not inappropriately reduced. **1. Comments to Section 2232.45.2: Benefit Reductions Shall Not Be Based on Involuntary Retirement.** (2) The proposed regulation at section 2232.45.2 would prohibit group disability income insurance policies (that are subject to approval under the California Insurance Code) from containing any terms that permit the disability insurer to estimate the retirement benefits a disabled beneficiary would receive if the insured retired and to accordingly deduct that amount	(3) No change. This comment does not address the changes made in the 15-day notice. To the extent it can be construed as doing so, there is no need to amend the regulations to accommodate this comment. (4) No change. This comment does not address the changes made in the 15-day notice. There is no need to amend the regulations to accommodate this comment. (5) No change. This comment does not address the changes made in the 15-day notice. There is no need to amend the regulations to accommodate this comment. (6) No change. This comment does not address the changes made in the 15-day notice. There is no need to amend the regulations to accommodate this comment. (7) No change. This comment does not address the changes made in the 15-day notice. The Department declines to accept the commentator's invitation to attempt to prohibit all offsets of any retirement benefits. The Department has concerns about the potential for double-dipping, a situation in which the disabled insured receives more money while disabled than while working. (8) No change. This comment does not address the changes made in the 15-day notice. However, the comment generally supports the regulation. There is no need to amend the regulations to accommodate this comment. (9) No change. This comment does not address the changes made in the 15-day notice. However, the

Commenter	Synopsis or Verbatim Text of Comments	Response
	from the beneficiary's disability benefit regardless of whether the beneficiary actually elects to receive her retirement benefits. The practice of taking estimated retirement offsets is, in essence, a way for group long-term disability ("LTD") insurers to force disabled employees to take retirement benefits that will reduce the insurer's liability and also reduce the employee's retirement income. The proposed regulation is consistent with existing federal and state law that prohibits employee benefit plans from requiring or permitting the involuntary retirement of an individual on the basis of that person's age, and it is necessary because it closes and clarifies gaps in the current law on estimated retirement offsets. **A. Federal Policy Provides Strong Protections for Retirement Benefits.** (3) To protect the health, safety, security, and simple peace-of-mind of older Americans federal law has long provided strong protections and incentives for retirement savings and benefits that are designed to ensure that those benefits will be available when they are needed: when people are too old to generate income from work. For example, retirement plans that meet qualification requirements under ERISA and the Internal Revenue Code receive favorable tax treatment such that contributions are tax-deductible or tax-deferred and plan investment earnings are not taxable to the plan, the employer, or the employee until distribution. See, e.g., Internal Revenue Code ("IRC") section 401. To ensure that this favorable tax treatment achieves its intended	comment generally supports the regulation. There is no need to amend the regulations to accommodate this comment. (10) No change. This comment does not address the changes made in the 15-day notice. However, the comment generally supports the regulation. There is no need to amend the regulations to accommodate this comment. (11) No change. It is unclear whether this comment encompasses any of the changes in the 15-day notice pertaining to the regulations cited. Regardless, there is no need to amend the regulations to accommodate this comment. (12) No change. This comment does not address the regulations in general or the changes made in the 15-day notice. Instead, it seeks to expand the scope of the regulations into a new area: dependent social security disability benefits. The Department declines the commentators' invitation to expand the scope of this rulemaking proceeding into this new subject area. There is no need to amend the regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
	results, some benefits under pension plans carry tax penalties if the benefits are distributed prior to retirement age. IRC section 72. One important requirement for tax qualification is that a plan prohibit assignment or alienation of benefits. ERISA section 206(d)(l), 29 U.S.C. section 1056(d)(l). So powerful is the anti-alienation rule that benefits under qualified pension plans cannot be reached by creditors in bankruptcy, Patterson v. Shumate, 504 U.S. 753 (1992), and a specific Congressional enactment, the Retirement Equity Act, was required before state courts were allowed to divide pension assets on divorce, see ERISA section 206(d)(3), 29 U.S.C. section 1056(d)(3). Disability policy provisions for estimating offsets of retirement benefits effectively cause an alienation of such benefits in favor of the insurer, in contravention of the public policy underlying the anti-alienation provision, and undermine the policy of encouraging deferral of income to retirement through favorable tax treatment. The strong federal policy of protecting retirement benefits for use during retirement counsels in favor of not allowing LTD insurers to take a bite out of those benefits by forcing beneficiaries to diminish their retirement assets as a source of disability insurance. This is precisely the effect of estimated offset provisions in LTD policies. Because the estimated offset puts the beneficiary in the untenable position of either drawing on their retirement assets or suffering a substantial income reduction based on a retirement benefit they do not receive, such practices should not be allowed in LTD insurance policies in California.	

Commenter	Synopsis or Verbatim Text of Comments	Response
	In contrast to the function of retirement benefits in providing income after an employee's working life is over, the purpose of long-term disability insurance is to replace income when the employee's working life ends prematurely (or is temporarily interrupted) due to illness or injury. Estimated offsets of retirement benefits conflate these two functions, and undermine both, by forcing employees to shift income from the retirement period into a period of pre-retirement disability. **B. Estimated Retirement Income Offsets Harm Individual Retirement Plan Beneficiaries and the Retirement System as A Whole.** **i. Defined Benefit and Defined Contribution Plans.** (4) There are two major categories of retirement benefit plans that estimated retirement benefit offsets will impact: defined benefit plans and defined contribution plans. A defined benefit plan is one in which the employee, upon retirement, is entitled to a fixed periodic payment, usually monthly, that is calculated using a formula that ordinarily takes into account years of service, age, and compensation. Defined benefit plans are often referred to as "traditional pension plans." A defined contribution or "individual account" plan is one in which the employee, upon retirement, is entitled to the balance of assets allocated to her account, which reflects employer contributions, employee contributions, and investment earnings or losses. See ERISA section 3(34), (35),29 U.S.C. section 1002(34), (35); Nachman	

Commenter	Synopsis or Verbatim Text of Comments	Response
	Corp. ***v.*** Pension Ben. Guar. Corp., 446 U.S. 359,364 (1980). **ii. The Effect of Estimated Offsets on Benefits Under Defined Benefit Plans.** (5) Estimated LTD offsets of early retirement benefits under defined benefit plans force disabled employees to either accept significantly reduced income while they are disabled and below normal retirement age (by not taking early retirement and absorbing the entire cost of the offset), or significantly reduced income after they reach normal retirement age (when they typically will no longer be eligible for LTD benefits and will also have a reduced annuity). Since it is generally financially disadvantageous to take early retirement benefits, and because reduced early retirement benefits will harm California's oldest citizens the most, LTD insurers should not be permitted to use estimated offsets to put disabled employees in the untenable position of choosing between impoverishment now or (unless they "win the bet" by dying young) impoverishment later. Defined benefit plans must prescribe a "normal retirement age," which cannot be later than age 65, at which employee-participants become eligible to receive their normal retirement benefits. ERISA sections 3(22), (24), 206(a), 29 U.S.C. sections 1002(22), (24), 1056(a). Many defined benefit plans also permit employees who meet certain	

Commenter	Synopsis or Verbatim Text of Comments	Response
	age and/or service requirements to receive an "early retirement benefit," that is, a benefit commencing before normal retirement age. However, such benefits typically are the actuarial equivalent of the normal retirement benefit; that is, because they are expected to be paid out over a longer period, the monthly benefit amount is reduced. (An early retirement benefit that is greater than the actuarial equivalent of the normal retirement benefit increases the employer's benefit cost.) Such a reduction typically is on the order of .5% per month before normal retirement age that the employee receives the benefit. This "age reduction" is a permanent reduction; the benefit does not increase upon the attainment of normal retirement age. Therefore, employees who take early retirement because of an estimated offset of benefits under a long-term disability policy will suffer a permanent reduction in the benefits accumulated for retirement. Again, the estimated offset has the effect of shifting income from the retirement period into the pre-retirement disability period. Thus, the disabled employee suffers a one-two punch to her retirement security: (1) the disability itself causes a loss of additional pension benefits that would have accrued had she been able to continue to work; and (2) the LTD offset causes a reduction of the pension benefits that have accrued due to early retirement. Nor should estimated LTD offsets be permitted for employees who are eligible to receive	

Commenter	Synopsis or Verbatim Text of Comments	Response
	normal retirement benefits under defined benefit plans. As an initial matter, group LTD plans that allow for disability benefits after a disabled employee reaches retirement age are, in our experience, extremely rare. Thus, this situation is not likely to arise very often. But, when it does, LTD insurers who chose to issue policies that insure disabilities after normal retirement age should not be permitted to shift the risk of those disabilities onto disabled beneficiaries' retirement assets. There are many reasons why it would not be in a disabled beneficiaries' interest to take an unreduced defined benefit pension after normal retirement age. For example, the disabled employee may hope to recover and return to work, and that might not be possible if the beneficiary commences receiving his pension, as was the case in Kalvinskas v. California Institute of Technology, 96 F.3d 1305, 1308-09 (9th Cir. 1996). Also, a beneficiary who purchases LTD insurance covering post-retirement age disabilities might desire to avoid pay status on their defined benefit pension because they are continuing to accrue benefits under the pension. **iii. The Effect of Estimated Offsets on Benefits Under Defined Contribution Plans.** Estimated retirement offsets have a potentially devastating effect on participants in defined contribution plans and should not be allowed. The principal concern with defined	

Commenter	Synopsis or Verbatim Text of Comments	Response
	contribution plans is that estimated retirement offsets could plausibly be used to compel premature distribution of defined contribution assets - with steep taxes and penalties to the employee. There are several different types of defined contribution or individual account plans, the most popular is commonly known as a 40 1 (k) plan. Under 40 1 (k) plans, early distributions are subject to immediate excise taxation plus a 10% penalty. Moreover, the assets lose their ability to grow tax-free until retirement. The entire point of these rules is to ensure that 401(k) assets are used for retirement and not as income during a participant's working years. Estimated LTD offsets that could plausibly force a premature distribution of 40 1 (k) assets should not be allowed under any circumstances as they would undermine the 401(k) system as a whole. Estimated offsets should also not be allowed where a 401 (k) participant would not face any premature distribution penalties (either because they are of age or qualify for an exception from the penalties). The core problem is that the defined contribution plan system only works if participant assets are kept in their accounts long enough to accrue substantial capital gains. Forcing distribution of these assets to insure workplace disabilities interrupts this system and prevents future capital gains on the assets. Another troubling issue is the difficulty of assessing a 401 (k) participant's "income" from the account. Unlike defined benefit plans, defined contribution plans do not	

Commenter	Synopsis or Verbatim Text of Comments	Response
	mandate a particular monthly benefit amount; instead the benefit typically is a single-sum distribution of the account balance. Once they reach retirement age, 401 (k) participants are generally free to draw on their assets as they see fit. Thus, an LTD insurer is in no position to estimate the monthly income that a 40 1 (k) participant should receive, and any offsets based on such estimates are bound to be flawed. As with defined benefit plans, early distribution of defined contribution plan assets shifts income from the retirement period to a pre-retirement disability period, when the employee had planned to be working and accruing retirement benefits. Forcing the employee to use retirement benefits during pre-retirement disability defeats the purpose of long-term disability insurance and dramatically escalates the risk that the employee will have inadequate support in retirement. **iv. LTD Offsets Based on Retirement Income Are Generally Inappropriate.** More fundamentally, we believe that the Commissioner should reconsider the policy of allowing LTD insurers to issue policies that permit offsets of any retirement assets at all. Pension plans and LTD insurance are cut from different cloth. Pension benefits are a form of deferred compensation and collective savings, accrued over a lifetime of hard work, that are meant to support workers in their later years (hopefully, in a manner that is comfortable and that rewards one's lifetime of toil). LTD insurance covers the	

Commenter	Synopsis or Verbatim Text of Comments	Response
	risk of catastrophic income loss as a result of sickness or injury during an employee's working years. LTD insurance policies that allow for retirement asset offsets are essentially shifting the risk of workplace disability onto retirement systems that were not designed to bear that risk. This is a deceptive practice that disguises the true cost of pre-retirement disability. We realize, assuming that existing LTD insurance policies providing for retirement income offsets are actuarially correct, that disallowing retirement-based offsets will result in increased LTD premiums. However, we believe that the benefits flowing to individuals and the retirement system as a whole outweigh this cost. Further, there is intrinsic social and economic value in ensuring that the costs of insuring pre-retirement disability are clear, accurate, and channeled through appropriate legal and economic institutions. **C. Benefit Reductions Based on Estimated Retirement Offsets Violate Federal Law.** The federal Age Discrimination in Employment Act (ADEA) expressly prohibits requiring a retirement plan beneficiary to involuntarily take retirement benefits because of the participant's age. 29 U.S.C. 5 623(f)(2). In Kalvinskas, the Ninth Circuit Court of Appeals held that it is a violation of this provision for a long-term disability plan to take an offset of estimated (but not received) retirement benefits which would	

Commenter	Synopsis or Verbatim Text of Comments	Response
	require a reasonable person to involuntarily take retirement benefits that he would not otherwise have to take. *Id.* at 1307-08. The proposed regulation at section 2232.45.2 is an important clarification of Kalvinskas. The Kalvinskas court explicitly noted that its holding was limited to situations where the estimated offset nullifies the entire LTD benefit. *Id* But, even where estimated retirement offsets do not offset the entire LTD benefit insureds can be put in the difficult position of sacrificing a substantial proportion of their monthly income now (by not electing retirement benefits), or sacrificing a substantial portion of their monthly income in retirement. Further, some employees (as was the case in Kalvinskas) may hope to recover from their disabilities and return to work despite their eligibility for unreduced retirement benefits. Forcing involuntary retirement by means of an estimated offset can deprive these employees of this option. Id. Thus, the justifications for not allowing estimated offsets that nullify the entire LTD benefit are equally valid where the offsets only partially reduce the LTD benefit, and the proposed regulation properly recognizes this fact. **2. Section 2232.45.4. Benefit Reductions Shall Not Be Based on Workers' Compensation Permanent Disability.** The proposed regulation at Section 2232.45.4 would prohibit provisions in California group LTD policies that allow the insurer to take an	

Commenter	Synopsis or Verbatim Text of Comments	Response
	offset for permanent disability payments under a worker's compensation settlement or judgment. We strongly support this regulation because it is consistent with California law, under which permanent disability payments are meant to compensate injured employees for their diminished capacity to compete in the labor market, not to replace income lost as a result of disability. See Russell v. Bankers Life Co., 46 Cal. App. 3d 405,415-16 (Ct. App. 1975); see also 8 Cal. Code Reg. 5 10151. Under the worker's compensation system, the loss compensated by permanent disability payments is different from that of temporary disability payments, which are specifically intended to replace lost wages as a result of a workplace injury - just like LTD insurance. Permanent disability benefits are based on a permanent disability rating, which is a numeric figure that expresses the permanent effects of an injury on the capacity of an employee to compete in the labor market and factors in the age of the employee and the nature of the injury. See Schedule for Rating Permanent Disabilities, incorporated by reference at 8 Cal. Code Reg. section 10151, available at `http://www.dir.ca.gov/dwc/PDR.pdf.` Unlike temporary disability payments (which cover lost wages), permanent disability payments deal with the residual effects of an injury (for example, pain and suffering) and are a replacement for tort damages. Disallowing LTD insurers from	

Commenter	Synopsis or Verbatim Text of Comments	Response
	offsetting permanent disability benefits is necessary to protect employees who suffer workplace injuries from indirect reductions in their compensation for those injuries. Further, banning the practice of offsetting permanent disability protects the integrity of California's worker's compensation system as a whole because it ensures that permanent disability payments will fully compensate the targeted loss. In their July 10, 2007, comments to this proposed regulation, the Association of California Health Insurance Companies and the American Council of Life Insurers argue that the proposed regulation is inappropriate because permanent disability benefits cover the same risk as LTD insurance and because the regulation will result in excess litigation and windfalls to disabled employees because worker's compensation settlements will be structured to avoid categorizing payments as temporary disability. As discussed above, the first point lacks merit. LTD insurance covers the risk of income loss as a result of sickness or injury. Permanent disability covers the long-term residual effects of a workplace injury. The second point proves too much. Employees already have an incentive to structure worker's compensation settlements so as to categorize the payments as being for losses other than temporary or permanent disability (e.g., medical costs, attorney's fees, vocational rehabilitation, and the like) because many LTD policies purport to give the insurer the right to offset	

Commenter	Synopsis or Verbatim Text of Comments	Response
	both categories of disability payment. Under the proposed regulation, workers' compensation settlements would actually become more clear, and the risk of an inappropriate windfall would be reduced, because employees will feel free to use the permanent disability rating system for its intended purpose without fear of harming their interests under an LTD policy. **3. Section 2232.45.3. Benefit Reductions Shall No Be Based on Estimated Workers' Compensation Temporary Disability Benefits Not Actually Received by the Insured.** The proposed regulation at section 2232.45.3 would prevent California LTD insurance policies from containing provisions that allow the insurer to offset LTD payments by estimating the amount of temporary disability benefits an employee might receive if she pursued workers' compensation benefits. This regulation is necessary to protect injured workers and the workers' compensation system. As with estimated early retirement offsets, estimated temporary disability offsets put a disabled beneficiary in the untenable position of either accepting a severe reduction in her monthly income, or filing a worker's compensation claim for temporary disability benefits. This creates a perverse incentive encouraging disabled employees to file questionable workers' compensation claims (which may take years to resolve) in an already over-burdened workers' compensation system. There is a parallel problem	

Commenter	Synopsis or Verbatim Text of Comments	Response
	plaguing the Social Security Disability Insurance system, which is overburdened by applications from individuals who do not meet the SSDI standard of disability, but are nonetheless pushed to apply for SSDI benefits by LTD insurers in search of offsets. This practice is currently the subject of several qui tam lawsuits. See Walsh, Insurers Faulted as Overloading Social Security, N.Y. TMS (April 1,2008) (attached as Exhibit A). **4. Comments to sections 2232.45.5 and 2536.2.** We strongly support the proposed regulations at sections 2232.45.5 and 2536.2, which would regulate LTD advertising practices and the practice of taking offsets for income generated by work performed while a beneficiary is disabled. These regulations will clarify existing legal requirements, prevent deceptive marketing practices, and protect employees from unreasonable actions by LTD insurers. ***5.* Additional Comments on LTD Offsets for Dependent Social Security** **Disability Benefits.** LTD insurance policies commonly take an offset for Dependent Social Security Disability benefits. We encourage the Commissioner to propose regulations banning this practice in California. Dependent SSDI benefits do not cover the same risk insured by LTD policies. Dependent SSDI benefits are the legal property of the dependent child, not the disabled caregiver; indeed, the disabled caregiver is legally	

Commenter	Synopsis or Verbatim Text of Comments	Response
	required to spend the dependent's benefit on the dependent's needs. It is a benefit program created by the federal government to ensure that the special needs of dependents of disabled persons are provided for by a separate and distinct benefit (e.g., special transportation costs). In contrast, we are not aware of any LTD insurance policies that provide an additional benefit for disabled employees with children. Therefore, it is inappropriate for LTD insurers to attempt to offset a disabled person's benefit by the amount of his dependent's disability benefits. See generally, Carstens v. US. Shoe Corporation's Long-Term Benefits Disability Plan, 520 F. Supp. 2d 1165 (N.D. Cal. 2007). Thank you for your consideration of these comments. Please do not hesitate to contact me with any additional questions or concerns.	
Ted M. Angelo, ACLHIC, and John Mangan, ACLI: Verbatim text of letter dated 4/23/08.	This letter is submitted on behalf of the American Council of Life Insurers and the Association of California Life and Health Insurance Companies, whose members write the majority of disability income insurance in the United States and California. We appreciate the opportunity to comment on the amended text to the above-referenced regulations that propose to govern benefit reductions in Disability Income Insurance products. These comments are intended to supplement many of the concerns outlined in our letter of July 10, 2007. (1) In many areas of the proposed regulations, we continue to believe the commissioner does not have the authority to promulgate these rules under Insurance Code sections 790.03,	(1) The Department amended the regulations as set forth above in prior responses to this commentator to address this commentator's issue regarding authority. There is no need to amend the proposed regulations to accommodate this comment further. This comment was made previously, in the commentators' July 10, 2007 comments. (2) The Department agrees with this comment. There is no need to amend the regulations to accommodate this comment.

Commenter	Synopsis or Verbatim Text of Comments	Response
	790.06 and 790.10. For example, only through an administrative hearing process is the Commissioner allowed to consider additional changes to 790.03 (which outlines specific prohibited acts). Additionally, in many areas of the proposed text, we believe the Office of Administrative Law/Administrative Procedure Act standards of Authority and Consistency are not met. **<u>Comments to Proposed Regulation 2232.45.2 (Retirement Benefits)</u>** (2) The amended language of proposed regulation section 2232.45.2 seems to satisfactorily address the Department's previous concerns regarding the potential for forced retirement. The revisions appear to resolve the concerns we had expressed that the Department was misinterpreting *Kalvinskas*. *Kalvinskas* addresses where benefits have the effect of forcing retirement, and cannot be read as supporting a prohibition on estimating offsets where the insured actually has retired. (3) However, in subsections (b) and (c), the proposed regulations continue to impose restrictions with respect to offsets for disability retirement benefits. When a carrier finds that an insured is eligible for benefits from a retirement plan to replace income lost due to a disability, a carrier should have the right to use an estimated offset for those benefits if: (a) the insured chooses not to apply for or pursue those disability retirement benefits, (b) the policy notifies the insured of his or her obligation to pursue those benefits, and (c) the carrier has a reasonable means of estimating the amount payable. Page 2 of 3 (4) The Commissioner must acknowledge that an insured has a duty to mitigate his or her damages. When an insured is eligible for a retirement benefit because of disability, but for whatever reason chooses not to apply for or diligently pursue those	(3) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (4) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (5) No changes are necessary in response to this comment. (6) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (7) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (8) This comment was made previously, in the commentators' July 10, 2007 comments. To the extent it

Commenter	Synopsis or Verbatim Text of Comments	Response
	benefits, an insurer should have the right to estimate those benefits. There is no legal authority that prohibits estimating an offset for disability retirement benefits. Failing to recognize the strong public policy requiring a party to a contract to mitigate their damages would unnecessarily result in increased costs for California employers and employees seeking group disability income insurance. **<u>Comments to Proposed Regulation 2232.45.3 (Workers' Compensation - Temporary)</u>** (5) We have no additional concerns with the amended text. (6) However, we continue to believe that this proposed regulation is unnecessary and overly broad. The apparent purpose of this regulation is to prohibit group disability insurers from offsetting estimated amounts of workers' compensation benefits when those benefits are being disputed. In those cases where workers' compensation is disputed, industry practice is to pay disability benefits without any offset and pursue recovery of any potential overpayment through the lien process. Thus, the regulation is unnecessary. (7) Also, the regulation seems to continue to prohibit an insurer from offsetting workers' compensation benefits in those situations where the insured fails to provide adequate notice of an accident that would give rise to a claim or fails to cooperate with the workers' compensation carrier's claim requirements. The duty of good faith runs both ways in an insurance contract and the insured has a duty to mitigate his or her damages. If an insured chooses to not pursue a claim for workers' compensation for which he or she is eligible and would be entitled had the insured diligently pursued that claim, the disability insurance carrier should not bear the burden. Instead, in that circumstance, sound public policy supports allowing the insurance company to reduce the insured's claim by that amount. There is no legal	reiterates the comments made on July 10, 2007, the Department's response is set forth above in its response to the commentator's July 10, 2007 comments. To the extent the comment addresses the inclusion of a new reference citation, <u>Canova v. N.L.R.B.</u> (9^{th} Cir. 1983) 708 F.2d 1498, it is incorrect. The <u>Canova</u> case confirms that, under California law, temporary disability payments are a substitute for lost wages, but permanent disability payments are not. "Because the California courts do not consider awards under the California permanent disability scheme as payment for past lost wages, we agree with the Board that Phillips' award for his permanent disability should not be deducted from his backpay recovery." <u>Canova v. N.L.R.B.</u>, (9^{th} Cir. 1983) 708 F.2d 1498 at 1504, citing <u>Mercier v. Workers' Compensation Appeals Board</u> (1976) 16 Cal.3d 711, and <u>Russell v. Bankers Life Co.</u> (1975) 46 Cal. App.3d 405. (9) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (10) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (11) This comment was made previously, in the

Commenter	Synopsis or Verbatim Text of Comments	Response
	authority for the Commissioner to prohibit parties from agreeing to recognize that public policy. **<u>Comments to Proposed Regulation 2232.45.4 (Workers' Compensation – Permanent)</u>** (8) This proposed regulation would continue to prohibit a group insurance policy from including an offset for permanent workers' compensation benefits. The cited authority does not provide a valid basis for the proposed regulation. Furthermore, the regulation would also encourage structuring workers compensation payments to avoid any offset. (9) The comments accompanying the proposed regulation cite to *Russell v. Bankers Life Co.*, (1975) 46 Cal. App. 3d 405. This proposed regulation misinterprets this decision, which did not hold that the offset was contrary to public policy, or inappropriate in all cases. It held only that the policy language in question did not clearly allow for the offset. The Department's stated rationale – that permanent benefits cover the employee's working capacity through retirement age – is in fact the best argument for allowing this offset, as most LTD policies are covering the same risk. (10) Allowing the offset to the extent that the award is attributable to the period for which benefits are payable under the disability policy is consistent with the Department's stated rationale. Failure to allow this offset results in situations where an LTD benefit, which pays a benefit through normal retirement age, is unable to take into account the workers' compensation award covering the same period of disability. This is still a problem and will likely make it impossible for insured LTD plans to avoid duplicate payments. (11) Further, the comments do not assert the Commissioner has legal authority to issue this regulation on the grounds that an	commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (12) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. To the extent it may be interpreted to encompass the changes made, the Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (13) This comment was made previously, in the commentators' July 10, 2007 comments. To the extent it encompasses the changes made, the Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. (14) The first portion of this comment was made previously, with the commentator's July 10, 2007 comments, and the Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments. The second portion of this comment specifically addresses the changed text. The insurers' marketing materials show that group disability income insurance benefits can be subject to many offsets. The regulation requires that the insurer choose just two common ones, for purposes of illustration, as Standard Insurance Company did in its brochure. The Department has included materials from the Social Security Administration website to show, based

Commenter	Synopsis or Verbatim Text of Comments	Response
	offset for permanent workers' compensation benefits is an unfair trade practice. Instead, the Commissioner asserts that he has authority to make the definition of unfair trade practices more specific. However, the Insurance Code specifically defines unfair trade practices in Cal. Ins. Code 790.03. Offsetting permanent workers' compensation benefits is not included within those definitions. Again, the only statutorily authorized way for the Commissioner to specify conduct as an unfair trade practice is through an administrative complaint and a hearing as described in Cal. Ins. Code 790.06. **<u>Comments to Proposed Regulation 2232.45.5 (Work Earnings)</u>** (12) This proposed subsection appears unnecessary and the cited authority does not support the authority of the Commissioner to issue it. Again, only through an administrative hearing process is the Commissioner allowed to consider additional changes to 790.03. This proposed regulation would require an insurer to have a good faith basis for estimating earnings that would be the subject of an offset. However, an insurer's duty of good faith is already implicit in the insurance relationship. **<u>Comments to Proposed Regulation 2536.2(b)(3)&(4) (Advertisements)</u>** (13) While we support the premise that the existence and effect of offsets should be made clear in conjunction with description of the amount of benefit payable, we believe the regulation continues to go too far in requiring advertisements to contain specific illustrative examples. (14) While improved, the guidelines are not necessary to make the effect of offsets clear, and in some cases may be a more confusing way of presenting the information to the consumer. A	on the SSA's own records, what percentage of claimants receive SSA disability benefits, and how much the benefits are. The Department has also included materials from the California Employment Development Department website which show the eligibility requirements for state disability benefits. Many individuals who qualify for benefits under a disability income insurance policy will also qualify for state disability benefits under the eligibility requirements listed. Some will also qualify for Social Security disability benefits. Social Security and state disability are two kinds of benefits which are typical of amounts that insurers will seek to offset against benefits payable under disability income insurance policies, and therefore they are used in the example in the regulations. The regulation gives the insurer leeway to select other offsets for purposes of the example, as long as the offsets are common. To eliminate confusion, the Department amended the regulation to provide that insurers may couple the example with a disclaimer which explains that the example is for purposes of illustration, and is not intended to reflect the situation of a particular claimant. The Department does not regard the record as having sufficient evidence to conclude that in most cases only one offset at a time reduces benefits under a disability income insurance policy. The lists of applicable offsets in the insurers' marketing materials, the percentage of social security applicants who receive social security benefits, the eligibility requirements for state disability benefits, and the fact that some of the materials reference a minimum benefit payment of as little as $100 per month indicate that more than one offset at a time may be applied in many situations.

Commenter	Synopsis or Verbatim Text of Comments	Response
	specific requirement that two offsets be illustrated could be very confusing, when most of the time there will only be one offset affecting a disability benefit at any given point. (15) Group disability insurance is offered by and through employers, who very often will create their own descriptive materials. In fact, employers will create their own descriptive materials if they consider the materials provided by the carrier to be too cumbersome. In our experience, carrier-created materials are most readily accepted by employers when they are clear and brief. Thank you for your consideration of these comments. Please feel free to contact us with any questions.	(15) This comment was made previously, in the commentators' July 10, 2007 comments. It does not address the revisions made in the April 8, 2008 version of the regulations. The Department's response to this comment is set forth above in its response to the commentator's July 10, 2007 comments.
	COMMENTS ON THE APRIL 24, 2008 VERSION OF THE PROPOSED REGULATIONS	
James P. Keenley, attorney with Lewis, Feinberg, Lee, Renaker, & Jackson: Verbatim text of letter dated 5/2/08 with summary of Exhibit A to the letter.	**Additional Comments on Proposed Revisions to California Code of Regulations Section 2232.45.4** Thank you for the opportunity to comment on the Insurance Commissioner's proposed revisions to the California Code of Regulations. Lewis, Feinberg, Lee, Renaker & Jackson, P.C. submits these comments to supplement our prior comments of April 23,2008, with recent legal authority supporting the Insurance Commissioner's proposed regulations prohibiting long-term disability ("LTD") insurance policies in California from containing provisions that allow the insurer to offset Permanent Disability payments under California's workers' compensation laws. In Alloway v. Reliastar Life. Ins. Co., Order Denying	No change. There is no need to amend the proposed regulation section to accommodate this comment. The only change to section 2232.45.4 that was subject to public comment in the second amended version of the regulations noticed to the public on April 24, 2008 is the addition of citations to the *Calfarm* case and the *Erreca* case. The *Erreca* case holds in part: "Disability insurance is designed to provide a substitute for earnings when, because of bodily injury or disease, the insured is deprived of the capacity to earn his living. (citation omitted) It does not insure against loss of income." In other words, disability income insurance insures against lost earnings, not lost income from other sources. The comment with its attached Exhibit A say nothing about the new citations to *Calfarm* and *Erreca*; therefore they are irrelevant to the changes noticed and no response

Commenter	Synopsis or Verbatim Text of Comments	Response
	Defendants' Motion for Summary Judgment, Case No. CV-06-4719 (CAS) (April 28,2008) (attached hereto as Exhibit A), Judge Snyder of the Central District of California recently held that Permanent Disability benefits under California's workers' compensation system could not be offset under a policy term allowing the insurer to offset "other income" from the beneficiary's disability payment. Id. at 6-17. The basis and scope of the Alloway decision underscores the pressing need for regulations clarifying that California law does not permit LTD insurance policies that purport to offset Permanent Disability workers' compensation benefits. In Alloway the court's precise holding was to deny the defendant-insurer's motion for summary judgment that it did not abuse its discretion under the Employee Retirement Income Security Act, 29 U.S.C. section 1001 et, seq. Under ERISA, if an employee benefit plan grants discretion to the plan administrator to interpret the terms of the plan, the administrator's interpretations of the plan are reviewed under an abuse of discretion standard when challenged in federal court. See generally Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 1 1 1-1 15 (1989). Where an administrator both administers the plan and pays benefits under the plan, Page 2 courts factor the conflict of interest into the standard of review. ***Id.*** In Alloway the court held that there were triable issues of fact as to whether the defendant-insurer's discretionary interpretation of the term "other income" to	is necessary. Nonetheless, the decision from the *Alloway* case supports a finding of necessity for section 2232.45.4. It exemplifies the need for a rule to clarify whether insurers may offset workers' compensation permanent disability benefits.

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	include Permanent Disability benefits was influenced by its conflict of interest and therefore rejected the defendant's motion for summary judgment. Alloway at 13. Uncontradicted evidence in the case showed that the defendant-insurer's practice for taking actual workers' compensation offsets was not consistent with its interpretation of the "other income" term, and therefore the court did not defer to the defendant's interpretation of that term as a matter of law. *Id.* Though we believe the result in Alloway is correct as a matter of ERISA law, it underscores the need for California to directly regulate the practice of issuing LTD insurance policies that allow insurers to offset Permanent Disability benefits. The policy in Alloway did not specifically include Permanent Disability payments in its definition of "other income," instead the policy just stated that "Workers' Compensation" benefits were included. Alloway at 6-7. The ambiguity of the term, combined with the defendant-insurer's structural conflict of interest and evidence that the insurer's practice was to only deduct "wage replacement" workers' compensation benefits, enabled the court to avoid deferring to the defendant-insurer's interpretation of the "other income" term. It is clear that if the term was not ambiguous, that is, if the policy was written to explicitly include Permanent Disability benefits in the definition of other income, the Alloway court would have had no choice under ERISA but to enforce the policy as written. Moreover, even under the ambiguous term, the result in Alloway might still have resulted in deferring to the defendant-insurer's interpretation of the "other income"	

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	term if it was not for unique and uncontradicted evidence suggesting that the desired interpretation was merely a convenient litigation position that did not reflect the actual practices of the insurer. Nor is it clear that the defendant-insurer's interpretation will ultimately fail when the issues are put to a trial. Thus, the underlying lesson of Alloway is that the protections ERISA affords to LTD beneficiaries are thin. The Insurance Commissioner's proposed regulations barring Permanent Disability offsets will address this problem by providing needed protections for California employees and the California workers' compensation system. As we discussed in our previous comments of April 23,2008, Permanent Disability does not protect employees from the same risk as LTD insurance. Permanent Disability is compensation for the employee's reduced ability to compete over the course of their entire career as a result of an on-the-job injury; essentially, it compensates injured employees for the residual harms of a workplace injury that previously were fn1 How exactly a conflict of interest alters the discretionary standard of review is unsettled and currently under Supreme Court review in Metlife v. Glenn, No. 06-923, Order Granting Petition for Writ of Certiorari (January 18,2008) (Question presented: "If an administrator that both determines and pays claims under an ERISA plan is deemed to be operating under a conflict of interest, how should that conflict be taken into account on judicial review of a discretionary benefit determination?").	

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	Page **3** remediable in tort. Permanent Disability is not wage-replacement for the direct economic loss that results from a disabling injury: income lost as a result of being unable to work, which is instead covered by the Temporary Disability workers' compensation benefit. LTD insurance, like Temporary Disability, replaces lost income as a result of disability, it does not insure against the many other long-term residual harms caused by a workplace injury. Allowing LTD insurance policies to offset Permanent Disability would frustrate the California workers' compensation system by shifting the risk of income loss onto a benefit system that was never intended to insure this risk. Thank you for your consideration of these comments. Please do not hesitate to contact me with any additional questions or concerns. Exhibit A: This is a copy of a U.S. District Court Central District of California Civil Minutes – General in *Alloway v. Reliastar Life Ins. Co. et al.* dated 4/28/08 in which the court denies Reliastar's motion for summary judgment. The case concerns a disability income insurance policy provision allowing offsets for "worker's compensation benefits" and whether this provision would allow offset of workers' compensation permanent disability benefits.	
	COMMENTS ON THE APRIL 24, 2008 VERSION OF THE PROPOSED REGULATIONS AND THE NOTICE OF ADDITION TO RULEMAKING FILE	
Ted M. Angelo,		

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Legislative and Regulatory Counsel, ACLHIC	(1) I am writing to supplement ACLHIC's previous comments regarding the most recent revisions to the Department of Insurance's proposed DII Benefit Reduction Regulations, pursuant to the May 9 deadline for additional comments. We are respectfully requesting that the Department allow for the following delayed implementation dates. Because the proposed regulations would have a significant impact on plan design and cost, if approved, we believe there needs to be a reasonable timeframe for carriers to implement the proposed changes. Therefore, we suggest that the Department adopt implementation rules that are consistent with those that were agreed to in the DII Settlement Agreement. For new issuance (applications received or proposals issued), there should be 60 days to comply after the effective date of the regulation. For in-force contracts, the changes would be prospective only, and would be required for in-force group disability income insurance policies with renewal dates, at the first rate change date following the effective date of the regulation or 60 days after the insurance carrier receives notice that the new regulation is in effect, whichever is later. We would greatly appreciate your favorable response to this technical request.	(1) No change. There is no need to amend the regulations to accommodate this comment. The Department will not request that the regulations become effective immediately upon filing with the Secretary of State. The Department will take these considerations into account in determining an effective date for the regulations.